IS ESG DISCLOSURE CREATING VALUE PROPOSITIONS FOR THE FIRMS? AN SLR AND META-ANALYSIS OF HOW ESG AFFECTS THE FINANCIALS OF A FIRM

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Abstract

This systematic literature review (SLR) delves into the evolving landscape of environmental, social, and governance (ESG) disclosures and their consequential effects on the financial performance of firms. As sustainability considerations increasingly influence investment decisions, corporations are compelled to integrate ESG factors into their reporting practices. The primary objective of this research is to comprehensively analyze existing literature, elucidating the patterns, trends, and key insights surrounding ESG disclosures and their repercussions on financial outcomes. The study employs a systematic approach to identify, evaluate, and synthesize pertinent research articles, academic papers, and industry reports. It explores the multifaceted dimensions of ESG disclosures, encompassing environmental stewardship, social responsibility, and governance practices. The analysis spans diverse sectors, examining how ESG reporting has become a crucial component of corporate transparency and stakeholder engagement. The review aims to distill overarching themes from the literature, providing a nuanced understanding of the relationship between ESG disclosures and financials. Preliminary findings suggest that ESG disclosures are positively associated with enhanced financial performance, fostering long-term value creation for firms. However, variations exist in the significance of these relationships across industries and regions. Furthermore, the review highlights the emergence of standardized frameworks and reporting guidelines as essential catalysts for advancing ESG disclosure practices. This research contributes to the ongoing dialogue on sustainable finance by consolidating diverse perspectives and methodologies found in the literature. The synthesis of existing knowledge seeks to inform future research directions, guide corporate practices, and assist policymakers in shaping frameworks that promote responsible and transparent business conduct. In total, 650 articles were reviewed to explore the effect the ESG disclosure has on the financial performance of the firms.

Keywords: ESG Disclosure, Financial Performance, Integrated Reporting, Sustainable Practices, Triple Bottom Line


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1. INTRODUCTION

One of the most pressing issues facing our globe right now is climate change, which has made all of us think about the viability of the Earth as a whole. According to the scientific community’s general view, human activities, particularly the burning of fossil fuels, is the main catalyst for the increase in global carbon dioxide (CO2) emissions. The majority of this CO2 increase has happened since roughly 1970, a time marked by a surge in global energy use, as shown by the fact that CO2 levels in 2019 were nearly 40% higher than those in the 19th century.

The result is a significant buildup of human-generated CO2 in the atmosphere, with some of it lingering for millennia instead of just decades or centuries. The significant and alarming deviation from historical norms is shown by a comparison of present concentrations with CO2 levels found in air samples taken from ice cores. Present concentrations are higher than those seen over the previous 800,000 years (Wolff et al., 2020).

The industrial sector is the one to mostly blame for a sizeable share of the global greenhouse gas (GHG) emissions. The primary sources of emissions include the processes involved in creating essential commodities like iron and steel, chemicals, petrochemicals, and other major industries, as well as the combustion of fossil fuels for energy (Ritchie, 2020). Deforestation, pollution, and the destruction of natural ecosystems are just a few of the numerous industrial processes and products that have a considerable negative influence on the environment. As it has the potential to spur economic growth while reducing its environmental impact, the industrial and corporate sectors must play a vital role in promoting sustainability as well. The industrial sector can also assist in combating climate change, and one of the most crucial ways it does so is by implementing sustainable practices.

Publicly traded businesses today are undergoing a paradigm change and are moving towards long-term sustainable environmental, social, and governance (ESG) objectives, that are very different from the traditional profit maximization goals concentrating on the short term only. This change reflects a growing understanding that ESG variables are important sources of corporate risk that can have an impact on an organization’s financial performance and overall profitability. Positive ESG performance can increase financial success, according to recent studies. Because of the prevailing concerns about climate change, businesses have realized that they must not only adopt sustainable practices but also effectively communicate to stakeholders how sustainability is reflected in their vision, governance, robust strategies, and financial decisions based on sustainable practices and strategies (Lai & Stacchezzini, 2021).

Perhaps because of the concerns discussed earlier, the “triple bottom line” (TBL) was the term, coined by Elkington (1998), which asserts that a company’s success should be judged in terms of its social and environmental effect, as well as its financial performance, is one of the key arguments in favor of a positive connection. As per Giner et al. (2012), this approach, which is based on the three core aspects of sustainable development, environmental integrity, social justice, and economic benefits, establishes the cornerstone for businesses as they transition to sustainability.

A foundation for establishing a competitive edge in the market has been accepted as the TBL philosophy, which includes planet, people, and profit. As a result, including sustainability in businesses’ operational and marketing strategies is essential for their success. According to this viewpoint, businesses that pay attention to ESG concerns are more likely to enjoy a competitive edge when it comes to luring investments, workers, clients, and suppliers, and are consequently more likely to be successful in the long run. An accounting strategy called TBL reporting is used in enterprises to improve stakeholders’ understanding of the organization. It goes beyond the typical financial aspects and offers perceptions of the company’s impact on the outside world. People, planet, and profit are the three main focuses of TBL (Jackson et al., 2011).

In 2015, the United Nations (UN) adopted the 2030 Agenda, which established 17 Sustainable Development Goals (SDGs) that must be accomplished by that year. These SDGs implicitly support the “three pillar model”, which builds on earlier initiatives by fusing the environmental, social, and economic facets of sustainability. The social part of sustainability is the eradication of poverty. The UN has urged cooperation from all sectors and stakeholders to achieve these 17 SDGs. By actively participating in global challenges and developing innovative business models that prioritize social and environmental sustainability, corporations can specifically play a crucial role in achieving this agenda. TBL involves focusing on economic, social, and environmental issues all at once, which is in line with the 2030 Agenda’s “three pillars” notion of sustainability (Sánchez-Chaparro et al., 2022).

Additionally, as society and market players increasingly recognize their significance, ESG aspects have gained greater importance (Huang et al., 2022), a company’s ability to manage crises and improve its financial performance can be greatly impacted by the adoption of long-term social responsibility pledges and ESG policies. According to Mattera and Soto (2022), during the crisis in Ukraine, energy companies that switched to renewable energy sources performed better financially and were less dependent on shaky markets. These results contribute to the advancement of the TBL theory and the creation of sustainable company strategies. Companies can strengthen their resilience and their capacity to survive crises while maintaining their long-term financial performance and reputation by applying ESG strategies, which in turn helps them find a balance between profit, people, and the environment (Mattera & Soto, 2022).

ESG reporting has its roots in the broader field of corporate social responsibility (CSR), which rose to prominence in the 1960s and 1970s in response to growing worries about the effects of company activities on society and the environment. The CSR movement gradually broadened its purview to include governance issues, giving rise to the ESG framework. Through the efforts of socially responsible investing (SRI) firms, the first ESG reporting rules arose in the 1990s, and since then, ESG reporting has gradually become a mainstream...
practice. At the moment, many businesses voluntarily share their ESG performance, and a variety of reporting formats and standards have been developed to help them with this process.

In contrast, the ESG philosophy has just recently, especially during the previous ten years, come into being. It has partly developed in reaction to perceived CSR approach shortcomings. ESG seeks to handle complex issues arising from the governance, social, and environmental aspects of business operations. CSR is described by the European Commission (n.d.) as the “responsibility of enterprises for their impact on society”. By asking businesses to absorb a variety of externalities connected to their activities, ESG broadens the definition of corporate accountability. It also satisfies investor demands for more thorough and open disclosure of a company’s operations. The ESG doctrine promises to provide systematic and representative insights into a company’s ESG-related influence, in contrast to CSR, which is frequently connected with voluntary and inconsistent data disclosures. Notably, it exhibits a greater regulatory orientation, which has resulted in the prompt adoption of numerous legislative measures intended to address important ESG concerns across numerous global locations (Nielsen & Villadsen, 2023).

The Swiss Federal Department of Social Affairs and the UN released a report in 2004 that is where the ESG acronym first appeared. Since its beginnings, ESG has transformed from its original form into a division of SRI and traditional CSR practices. There has been a noticeable increase in the integration of sustainable methods as public awareness of corporate environmental efforts has grown. A growing number of businesses are opening up their ESG-related data to public inspection as a result of this transition. This increased attention to ESG factors has broadened its scope to include concerns about climate change and the improvement of working conditions. These worries now include things like safety infractions. This broader viewpoint emphasizes how important ESG factors are becoming in the corporate world (Helfaya et al., 2023).

The stakeholder theory also contends that conflict resolution can be aided by sustainable practices, which deters executives from over-investing in social responsibility and environmental sustainability for their gain. As a result, this study investigates how closely sustainability goals are related to top executives’ compensation. It also investigates the effect on shareholder value of the relationship between chief executive officer (CEO) compensation and sustainability goals for the benefit of other stakeholders. According to empirical data, the United Kingdom (UK) companies are increasingly using sustainability incentives. This trend may be explained by certain company characteristics, including the firm’s size, the independence of the compensation committee, the sustainability committee, the sustainability index, and resource efficiency policy components. As a result, numerous industries can benefit from sustainability incentives (Aboud & Diab, 2018).

Based on the needs of the users and the priorities which were derived from a prioritization of the financial performance of a corporation, and as a result, these variables differ greatly. The consolidated results of all the activities carried out by the business during a financial period are presented in the financial results published by the businesses in their financial statements, which include the balance sheet, the income statement or the profit and loss account, the statement of changes in the equity, and the cash flow statement. These financial results are used for various purposes by numerous investors. Investors have identified that the earnings and the market value of the shares appropriately reflect the effectiveness of the company's financial performance, taking into account the time value of money and the risks associated with unknown future cash flows. Increasing shareholder wealth is the same as maximizing stock market value (Almogtamel & Abbas, 2020). This perspective is based on the idea that increasing shareholder wealth is essentially the same as increasing stock market value (Akuç, 2017; Boaventura et al., 2012).

Various factors that have been researched as determinants of financial performance were further examined, including size, age, diversification, market share, growth, leverage, liquidity, profitability, research and development (R&D) investment, advertising investment, quality of goods and services, and capital investment decisions. According to the analysis, some of these variables consistently affect financial performance, while others have erratic or marginal effects (Capon et al., 1990). Revenue, operating income, contribution margin, return on investment, and return on equity are the most popular and often utilized financial indicators for assessing a company (Dossi & Patelli, 2010).

Utilizing several ratios, such as liquidity ratios, profitability ratios, solvency ratios, efficiency ratios, and leverage ratios, is necessary to evaluate a company’s financial performance. Metrics like return on investment (ROI), return on equity (ROE), return on assets (ROA), and earnings before interest and tax (EBIT) profit are all included in profitability ratios. According to Fathiuddin et al. (2018), liquidity ratios include measurements like the current ratio, cash ratio, net working capital ratio to total assets, and debt-to-equity ratio. These variables are expanded upon in more recent research (Boaventura et al., 2012), which also includes a wider variety of financial performance assessment measures. Indicators including ROA, ROE, sales growth, return on sales (ROS), contribution margin, Tobin's Q, market share, firm risk, return on capital employed (ROCE), operational profit, cash flow, and profits per share are included in this list of factors. The most often used accounting-based metric of financial performance, it should be noted, is ROA. However, when using ROA, it is crucial to proceed with caution. ROA, despite its widespread use, largely measures short-term performance and might not accurately reflect long-term performance dynamics. So, to evaluate a company’s financial health holistically, factors other than ROA must be considered.

The rest of the paper is structured as follows. Section 2 presents the background and the motivation of the study. Section 3 specifies the research objectives and methodology. Section 4 covers in detail the literature review categorized under various domains. Section 5 provides the conclusion, the implications, the limitations, and the further scope of the research.
2. THE THEORETICAL BACKGROUND AND THE MOTIVATION FOR THE STUDY

The current systematic literature review (SLR) is done to explore the work done in the area of ESG disclosures and their impact on firms’ financial performance. As far as the information and efforts we have put in, we could not find any SLR with bibliometric analysis done in this very specific area. We have also done the content analysis and have included the summary of the top cited 70 papers in this paper to give the researchers a fair idea of what the previous studies have covered and what the probable areas for future research are by looking at this single paper.

The conventional wisdom holds that a company’s main goal is to increase the wealth of its owners. However, when taking a stakeholder viewpoint, it becomes clear that many different organizations, including staff members, vendors, clients, communities, financial institutions, and regulatory agencies, are essential parts of a company’s complex ecosystem. Through the examination of the relationship between corporate profitability and the happiness of various stakeholders, survey data analysis has revealed that these important stakeholders can be viewed as a group with common goals and interdependent interactions. According to this viewpoint, businesses with more robust ESG disclosure are probably more appealing to both financial investors and other important stakeholders. As a result, this strengthens the relationship between businesses and their numerous stakeholders, which eventually results in long-term financial benefits for the participating organizations (Preston & Sapienza, 1990).

An enormous amount of data research exists in the area of non-financial reporting or presenting the practices that corporations follow to express their responsibility towards the ecosystem in which they operate. Extensive research is done on CSR reporting and its relevance to the firms’ performances but ESG disclosure and reporting, being a comparatively new area, has not been explored to that extent and has just started gaining momentum. This SLR explores all the areas covered by the earlier research work that has taken place on ESG disclosures, and their effect on corporate performance is examined in this systematic literature review. ESG reporting and different aspects of company performance have been the subject of research by academics, practitioners, and policymakers due to the increasing emphasis on corporate responsibility and sustainability. This review contributes to a deeper knowledge of this crucial nexus by synthesizing the important findings, methodology, and trends from a wide range of research articles published in top academic journals.

The review starts by describing the drivers behind ESG disclosures, clarifying how elements including stakeholder expectations, legislative changes, investor preferences, and ethical imperatives shape how businesses disclose information. The influence of ESG disclosures on organizations’ performance is then explored in depth, covering financial, operational, reputational, and strategic aspects. This study highlights empirical research that investigates the relationship between ESG disclosures and financial performance indicators including ROI, ROE, and stock market performance, and evaluates them. It clarifies the measurement and quantification methods used, showing the many study approaches, data sources, and statistical methods.

The review also acknowledges the complexity and difficulties that come with carrying out research in this field, including problems with data quality, standardization, and causation. It highlights the need for more extensive, longitudinal analysis and cross-industry comparisons while discussing the shortcomings of previous studies and outlining potential research directions.

Looking at the magnitude of the problem related to ESG practices, and the efforts of making companies responsible and reporting whether they are complying with what is required or not, regulatory authorities worldwide have introduced the reporting frameworks. Some of the frameworks are discussed hereafter.


The Non-Financial Reporting Directive (NFRD) obliges some significant public interest firms in the EU to include diversity-related and non-financial information in their annual reports.

For publicly traded corporations in the United States (US) and international markets, the Sustainability Accounting Standards Board (SASB) offers sustainability accounting standards based on industry.

A well-known framework for sustainability reporting is provided by the Global Reporting Initiative (GRI), which enables firms to publish data on a variety of ESG issues.

The Task Force on Climate-related Financial Disclosures (TCFD) has developed a disclosure framework that the Financial Conduct Authority (FCA) has mandated in the UK with regard to ESG problems.

A widely accepted framework for integrated reporting is provided by the Integrated Reporting Framework, which is now a part of the International Financial Reporting Standards (IFRS) Foundation. This paradigm helps businesses explain how, in light of their external conditions, their strategy, governance, performance, and prospects contribute to value creation throughout the short, medium, and long term.

India has established new rules for reporting on issues related to the ESG, with a focus on the top 1,000 publicly traded companies according to market size. Business Responsibility and Sustainability Reporting (BRSR) was initially discretionary for the fiscal year 2021–2022; however, it has become mandatory as of the fiscal year 2022–2023 for the top 1,000 listed Indian companies by market capitalization (Bhatia, 2021).

3. RESEARCH OBJECTIVES AND METHODOLOGY

Research objectives that are addressed to make this contribution are as follows:

1. To study and present the most relevant areas of academic research on analyzing ESG disclosures and the impact of the same on firm performance.
2. To present the research done in the past in this domain in a precise way to let the potential researchers know the perspective and the aspects of ESG reporting on the varied spectrum of business entities.

3. To present the scope of potential growth and implementation of ESG disclosures in the corporate world and amongst the regulators.

The current study employs SLR following the principles mentioned in the earlier excellent research studies by profound researchers like Tranfield et al. (2003) and Fethi and Pasiouras (2010).

The following stages of the process were followed:

P I. Careful preparation of what has to be evaluated.

P II. Carrying out the review.

P III. Compiling and presenting the review’s findings.

Each stage is broken down into several phases. Figure 1 depicts the process and makes it simple to understand the duties associated with each level.

Figure 1. Stages followed in the research

Since the research papers listed in these databases are of good quality and are simple to access for researchers, we looked for the following keywords in the database of Scopus, Web of Science (WoS), and Google Scholar. We decided that the final selection was going to be dependent on citations, which are a representation of the quality of work done by an author, and thus, we chose the database for its wider scope as well.


The results included research on CSR also as corporate social responsibility is considered to be an older concept and the “Social” factor amongst the ESG incorporates this as its integral part. Though, as discussed earlier ESG is a new term comparatively and the practices under it are way different than as undertaken by the CSR, the literature has plenty of work done under the CSR coverage which shows up as part of the ESG when searched for.

\[
SM_{ij} = CN_{ij} / TC_{ij} \quad (1)
\]

In the second step, the meta-analysis is incorporated. It takes care of the variables used in the research as the explanatory variables and to see how these complement the research with the effect size. There are two approaches to meta-analysis viz. fixed effect and random effect model. Under both, the effect size reported in the study is calculated. This study used a random effect model. In the fixed effect model, the size is calculated as:

\[
V_f = \frac{1}{N-3} \quad (2)
\]

\[V_f\] is the variance within the study and \(N\) is the size of the sample variables of the study. The weight is calculated as follows:

\[
W_i = \frac{1}{V_f} \quad (3)
\]

In the random effect model, no single effect size of a sample of studies exists but that keeps on changing research work to work. It is the total of all the variables from within the research and between the research studies.

\[
Total\ Variance = V_f + t^2 \quad (4)
\]
$t^2$ is between the study’s variance and is calculated as:

$$t^2 = \frac{Q - df}{C} \tag{5}$$

and

$$Q = \sum_{i=n}^{k} w_i Y_i - \left(\frac{\sum_{i=n}^{k} w_i \beta_i}{\sum_{i=n}^{k} w_i}\right)^2 \tag{6}$$

$w_i$ is the weight of the study:

$$df = k - 1 \tag{7}$$

df is the degree of freedom and $k$ is the number of researches in a certain field.

$$C = \sum_{i=n}^{k} \frac{w_i \beta_i}{\sum_{i=n}^{k} w_i} \tag{8}$$

The average effect size has the calculation as below:

$$M = \frac{\sum_{i=n}^{k} w_i \beta_i}{\sum_{i=n}^{k} w_i} \tag{9}$$

$$W_i = \frac{1}{T.V.} \tag{10}$$

Using automated tools and the criteria of at least two published papers in the first round of research article shortlisting, we were able to find relevant research written by only 32 authors. This was carried out to monitor the quality of the articles chosen for our SLR. We amended the criteria such that it was dependent on the number of citations the research work had been able to receive rather than the number of articles the authors had authored since the number of articles that passed this requirement was fairly few to conduct the SLR.

**Figure 2.** The trend of year-wise publication

**Figure 3.** The journals with the highest citations
A total of 1,062 articles were resulted by the search queries of which 15 missed the year of publication information, 17 were in other languages than English, and 380 were either missing some information or had zero citations, which were all excluded from the purview of the study. After going through the remaining papers very attentively, it was found that 434 had irrelevant titles and those were also excluded as those did not serve the purpose of the study. Then to include the top few papers for the researchers' benefit, we kept the criteria to do the content analysis of only those published papers that had citations of more than 125. Thus, finally, the papers that were shortlisted for the SLR numbered to be 66 (Figure 5). The period of 2010 to 2023 was considered for shortlisting the paper and most of the papers discussed in this SLR pertain to that period except for a few which refer to the theories and underlying philosophies belonging to a prior period.
Table 1. Top cited 15 research papers in the domain of ESG/CSR and financial performance

<table>
<thead>
<tr>
<th>Source</th>
<th>Title</th>
<th>Citations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Friede et al. (2015)</td>
<td>ESG and financial performance: Aggregated evidence from more than 2000 empirical studies</td>
<td>2195</td>
</tr>
<tr>
<td>McWilliams and Siegel (2000)</td>
<td>Corporate social responsibility and financial performance: Correlation or misspecification?</td>
<td>2053</td>
</tr>
<tr>
<td>Ameer and Othman (2012)</td>
<td>Sustainability practices and corporate financial performance: A study based on the top global corporations</td>
<td>958</td>
</tr>
<tr>
<td>Velte (2017)</td>
<td>Does ESG performance have an impact on financial performance? Evidence from Germany</td>
<td>728</td>
</tr>
<tr>
<td>Wang et al. (2008)</td>
<td>Too little or too much? Untangling the relationship between corporate philanthropy and firm financial performance</td>
<td>721</td>
</tr>
<tr>
<td>Fatemi et al. (2018)</td>
<td>ESG performance and firm value: The moderating role of disclosure</td>
<td>692</td>
</tr>
<tr>
<td>Gillan et al. (2021)</td>
<td>Firms and social responsibility: A review of ESG and CSR research in corporate finance</td>
<td>577</td>
</tr>
<tr>
<td>Li et al. (2018)</td>
<td>The impact of environmental, social, and governance disclosure on firm value: The role of CEO power</td>
<td>525</td>
</tr>
<tr>
<td>Nollet et al. (2016)</td>
<td>Corporate social responsibility and financial performance: A non-linear and disaggregated approach</td>
<td>500</td>
</tr>
<tr>
<td>van Duuren et al. (2016)</td>
<td>ESG integration and the investment management process: Fundamental investing reinvented</td>
<td>499</td>
</tr>
</tbody>
</table>

Table 2. Top cited 15 journals

<table>
<thead>
<tr>
<th>Name of journal</th>
<th>Citations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Journal of Business Ethics</td>
<td>4420</td>
</tr>
<tr>
<td>Sustainability</td>
<td>3246</td>
</tr>
<tr>
<td>Journal of Sustainable Finance &amp; Investment</td>
<td>2394</td>
</tr>
<tr>
<td>Journal of Cleaner Production</td>
<td>2101</td>
</tr>
<tr>
<td>Business Strategy and the Environment</td>
<td>1576</td>
</tr>
<tr>
<td>Financial Analysts Journal</td>
<td>1133</td>
</tr>
<tr>
<td>The British Accounting Review</td>
<td>1084</td>
</tr>
<tr>
<td>Finance Research Letters</td>
<td>982</td>
</tr>
<tr>
<td>Journal of Management Studies</td>
<td>901</td>
</tr>
<tr>
<td>Global Finance Journal</td>
<td>844</td>
</tr>
<tr>
<td>Journal of Corporate Finance</td>
<td>839</td>
</tr>
<tr>
<td>Organization Science</td>
<td>721</td>
</tr>
<tr>
<td>Strategic Management Journal</td>
<td>708</td>
</tr>
<tr>
<td>Journal of Global Responsibility</td>
<td>700</td>
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</tbody>
</table>

The summary of all the top cited 66 papers has been presented here for the researchers. The earlier year research talked about CSR only as the ESG is a term tossed very recently and hence, this summary includes papers which had CSR representing the socially responsible practices of the corporates. We have tried to categorize the papers into the pertinent categories as all try to address some of the other research objectives, the categories may have some overlap as well.

Table 3. Categories of contents of top cited paper on ESG disclosures

<table>
<thead>
<tr>
<th>Contents of papers (divided into major categories)</th>
<th>Number of papers published under the respective categories</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSR and profitability</td>
<td>9</td>
</tr>
<tr>
<td>Sustainable practices and financial performance</td>
<td>24</td>
</tr>
<tr>
<td>Role of CEO/board/gender and the impact of ESG</td>
<td>4</td>
</tr>
<tr>
<td>Impact of ESG on the financial sector</td>
<td>3</td>
</tr>
<tr>
<td>ESG and cost of capital</td>
<td>3</td>
</tr>
<tr>
<td>Investment decisions and ESG</td>
<td>8</td>
</tr>
<tr>
<td>Time horizon as moderator</td>
<td>1</td>
</tr>
<tr>
<td>ESG in unprecedented times</td>
<td>1</td>
</tr>
<tr>
<td>ESG ratings</td>
<td>6</td>
</tr>
<tr>
<td>ESG and risk</td>
<td>2</td>
</tr>
<tr>
<td>Press news and ESG</td>
<td>3</td>
</tr>
</tbody>
</table>

4. LITERATURE REVIEW: CATEGORY-WISE SUMMARY OF RESEARCH PAPERS

4.1. CSR and profitability

Business organizations are becoming more and more interested in corporate social responsibility. While some managers have contributed additionally to these requirements, others have declined, typically citing concerns about the supposed trade-off between socially responsible behavior and profitability. As a result, management researchers have investigated how CSR affects the topline of the firms. However, the outcomes of empirical studies examining the link between CSR and profitability have been inconsistent and thus necessitate additional research (McWilliams & Siegel, 2000).
Realizing the strategic benefit of stakeholder engagement and maximizing shareholder value requires efficient integration of CSR strategies with a company’s core business and production processes. CSR projects frequently span several areas and may consist of a variety of unrelated efforts. Corporate managers generally lack a cogent framework for committing to and bundling various CSR activities in a forward-looking manner to accomplish clear performance targets, even though stakeholder theory strongly links CSR with stakeholder management to achieve strategic objectives. The second important management implication that concerns corporate executives who are directing their organizations toward stakeholder-focused CSR participation is to make wiser choices regarding the distribution and use of company resources and they must understand the contingent nature of CSR (Hasan et al., 2018).

On the other hand, a company’s financial performance typically suffers when it takes an uneven approach to CSR. This conclusion should serve as a warning to businesses that if they participate only sometimes or sporadically in CSR initiatives, the stakeholders are unlikely to perceive such gestures as genuine, leading to limited realization of expected benefits. Moreover, this inconsistency hinders the learning process, and prolonged periods of inactivity can hinder the firm’s ability to effectively absorb CSR knowledge (Tang et al., 2012).

A substantial and evident correlation exists between corporate financial performance (CFP) and CSR, specifically of both Tobin’s Q and ROA. This correlation remains significant keeping in consideration the factors like firm strategy and operating environment influences. Furthermore, a firm’s strategic variables wield a direct impact on CFP, a relationship that is influenced by the moderation of stakeholder management, denoted by CSR variables (Theodoulidis et al., 2017).

The findings also imply that, rather than focusing on whether corporate charity contributions have a positive, negative, or neutral impact on the financial performance of their company, managers should focus on determining the ideal range of CSR activities that are most likely to be successful. Managers must comprehend that corporate philanthropy is an essential part of running a company and that it genuinely aligns with ethical business practices to achieve this. Financial results can be improved, and more meaningful engagement in philanthropic activities can be encouraged, by having a better understanding of how corporate philanthropy improves society (Teng et al., 2022; Wang et al., 2008).

According to Nollet et al. (2016), corporate social performance (CSP) and return on capital have a significant inverse connection. The research provides strong evidence for a U-shaped relationship between CSP and the accounting-based metrics of CFP. This suggests that with time, the effects of CSP on corporate performance get better. A U-shaped relationship between CSR performance and accounting-based CFP is shown by the data. This implies that CSR programs only have positive outcomes when a certain volume of investments and CSP accomplishments have been made. Before this, increasing CSR expenditures causes a decrease in CFP. CSR-focused governance has positive effects on firm performance and is consistent with recent improvements in the theoretical literature, supporting the idea of stakeholder influencing capacity.

Awaisheh et al. (2020) state the relationship between CSR and financial performance should be reevaluated. To achieve this, they study organizations and compare those to their industry peers over a year. This methodology aids in identifying businesses with the best CSR practices (best-in-class) and the poorest practices (worst-in-class). This study also factors in a number of elements that include the propensity for CSR scores to cluster around the median as well as the fluctuations seen over time and in various industries. Additionally, it discusses how extreme numbers could affect financial performance ratios. According to the findings of Tobin’s Q, best-in-class companies — those who excel at CSR — tend to outperform their sector rivals in terms of operating performance and enjoy higher relative market valuations.

Franco et al. (2020), in their study, uncover evidence supporting the positive impact of high levels of CSR on CFP. The relationship between CSR and CFP is best characterized as U-shaped, where weak CSR results are linked to negative performance outcomes. However, beyond a certain threshold, the implementation of CSR positively influences CFP. This research makes a significant contribution to the stakeholder theory by illuminating how stakeholders react negatively to businesses that make insufficient CSR efforts but favorably to those that make strong CSR efforts. This study also contributes to the body of knowledge on how CSR and quality management (QM) affect business performance. It proposes a contingency strategy in which QM is seen as having the ability to control the CSR-CFP relationship. As a result, the study contends that organizations involved in both quality management and corporate social responsibility may see lower financial returns than businesses that focus solely on such endeavors.

Environmental, social, and governance or company social responsibility are common labels for these company behaviors. While some results are well-established, others suggest that research on the relationship remains a need for further study that fills in the gaps and broadens our comprehension of these problems. Further research into the economic factors underlying major outcomes is essential. Are the leadership and governance of the company the main determinants of the firm’s social performance, or do companies with good social policies tend to embrace or draw in particular sorts of leaders and governance practices? How much are the needs and preferences of owners or society at large influencing business factors? The literature continues to argue whether CSR initiatives may reduce risk and possibly increase business value, despite a rising body of data to the contrary. Therefore, additional investigation and analysis are required to clarify these intricate relationships (Gillan et al., 2021).

4.2. Sustainable practices and financial performance

In the contemporary business landscape, publicly listed companies worldwide are undergoing a paradigm shift, transitioning from short-term profit-maximization objectives to embracing
enduring and sustainable ESG goals. This shift reflects a growing recognition of ESG factors as significant sources of corporate risk, capable of influencing the financial performance of a firm and overall profitability. The research conducted by Zhao et al., (2018) delves into this relationship within the energy power sector, revealing that robust ESG performance can contribute to enhanced financial outcomes. Additionally, the study discusses how the adoption of ESG disclosure is influenced not only by perceived benefits and rationale but also by the firm’s size, industry segment, and ownership structure, among other factors. This multidimensional analysis underscores the diverse motivations behind ESG disclosure across different countries and corporations.

Given the increased institutional attention on this component in the wake of the dotcom bubble and the Global Financial Crisis (GFC), this emphasis is particularly noteworthy. Surprisingly, when compared to medium or low-impact industries, sectors having a significant impact or those that are expected to counter pressure regarding ESG problems did not exhibit improved performance in governance or environmental facets. Instead, they mostly showed progress in the social dimension. Although there is strong institutional pressure in Australia to address ESG issues, other factors may contribute to the speed and severity of ESG performance manifestation. Instead, the unique internal traits of each firm could be quite important (Galbreath, 2013).

De Silva Lukuwadage and Heenetigala (2017) delve into an analysis of ESG disclosure practices within the mining sector, focusing on companies listed on the Australian Stock Exchange to examine how stakeholder influence and legitimacy-building efforts impact the ESG disclosure motivations of these firms. They found that certain ESG aspects that might have a negative impact on a company’s legitimacy are either underreported or not reported at all. This underscores the influence of a firm’s ESG legitimacy on its disclosure motives.

While ESG weaknesses have a detrimental effect on corporate value, ESG strengths have a positive impact. In a unique study, independently, ESG disclosure alone is also found to reduce on company value. A more nuanced perspective emerges, though, when the relationship between ESG disclosure and strengths or weaknesses is investigated. When ESG strengths exist, high levels of ESG disclosure lessen their positive valuation impact. One explanation for this result may be that the market may look at greater disclosure as the company’s attempt to defend an excessive investment in ESG operations. This demonstrates that a careful balance must be established between such disclosure and the actual strengths or weaknesses of a company when assessing the impact of ESG disclosure on firm value (Fatemi et al., 2018).

The question of whether the ESG component influences the various financial performance measurements and, more importantly, how much it varies by industry or sector, remains a pertinent research area. Alareeni and Hamdan (2020) looked into the fact that there were any relationships between a company’s operational performance (ROA), financial performance (ROE), and market performance (Tobin’s Q) and its disclosure of ESG factors. Additionally, whether these relationships are beneficial, negative, or neutral is a subject of inquiry. The results show that ESG disclosures have a favorable impact on a company’s performance measures. The disclosure of environmental and social practices, however, exhibits negative connections with ROA and ROE but shows a favorable link with Tobin’s Q, according to a detailed analysis of individual ESG sub-components. On the other hand, governance transparency demonstrates a favorable relationship with ROA and Tobin’s Q while maintaining a poor relationship with ROE. An interesting finding is that companies with significant assets and high levels of financial leverage frequently exhibit increased degrees of disclosure about socially responsible behavior, environmentally friendly projects, and corporate governance standards.

The results of a study done by Ameer and Othman (2012) indicate that global sustainable companies prioritize eco-centric issues more than ethnocentric issues. The statistical analysis confirms that companies focusing on sustainability practices tend to exhibit a higher profit. As evidenced by higher ROA, more profit before taxation (PBT), and more cash flow generated from operating activities compared to those without such commitments, particularly in certain sectors.

Accounting-based financial performance (ROA) is positively influenced by ESG performance scores overall and by its three components. Further investigation reveals that when compared to environmental and social factors, governance performance has the greatest influence on financial performance. The longer history of corporate governance reporting or the increasing value relevance for stakeholders may be responsible for this result, but the study did not discover any appreciable effects of ESG on market-based financial performance (Tobin’s Q) (Velte, 2017).

The study by Miroshnychenko et al. (2017) unambiguously validates the connection between the forecasted market worth and profitability of an organization with its adoption of environmentally responsible practices. This supports the prevailing theoretical perspective that Corporate Environmental Performance (CEP) has a profoundly favorable impact on corporate financial performance (CFP). The study’s findings emphasize that environmental practices can promote long-term economic growth and provide empirical support for policymakers. This insight is especially important for countries trying to switch to greener economies since it creates lasting benefits for all parties involved.

Yoon et al. (2018) also state that implementing socially responsible practices substantially and favorably influences a firm’s market value. The findings of their research indicate that the impact of corporate governance practices on firm valuation is markedly positive for chaebols, while it is either negative or lacks significance for typical Korean firms.

Yu et al. (2018) find that, for an average listed company, the benefits of ESG disclosure are far more than the costs involved and they draw the conclusion that lowering information asymmetry and agency costs is the key to improving ESG transparency’s influence on firm value. The research provided corroborating evidence that increased disclosure of ESG matters contributes to

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the enhancement of firm valuation metrics, including Tobin’s Q. Moreover, the study revealed that larger firms, with improved liquidity, higher levels of R&D investment, lower insider ownership, and favorable historical financial performance tend to exhibit higher transparency in addressing ESG concerns.

Traditional financial wisdom suggests that reduced risk results in diminished returns. In contrast to this notion, novel mathematical analysis presented in a study reveals that businesses integrating ESG elements exhibit that the volatility in their stock performance has decreased compared to industry counterparts. Furthermore, the impact of ESG factors on each industry varies, and it is demonstrated that ESG-oriented companies typically yield superior returns (Ashvin Kumar et al., 2016).

A study done by Siew et al. (2016) stands out for its investigation of how institutional shareholding and ESG reporting affect firm valuation assessment. A consistent conclusion indicates that market information asymmetry and ESG disclosures are positively correlated. The findings unmistakably show an inverse link between the aggregate impact of ESG disclosures, the percentage of aware investors, and the asymmetry of market information. This finding emphasizes how important ESG disclosures are in affecting information asymmetry in the market. The study suggests that regulators should think about regulating both the cadence and quality of ESG data that businesses publish. Such regulation is necessary to guarantee a fair and equal playing field for all parties concerned. Another intriguing finding from this study is that, when compared to ESG disclosure scores from the current year, disclosure scores from the prior year show a greater correlation with the bid-ask spread. This shows that rather than using the most recent ESG data, investors typically depend more on past information provided by companies. As a result, the lag effect becomes more obvious.

ESG disclosure and economic, environmental, and social (EES) sustainability performance have a positive correlation, according to a study on CSP in the context of EES dimensions. The study offers proof that demonstrates how environmental and social initiatives implemented within an effective structure of corporate governance improve corporate sustainability performance. The results also show a strong positive correlation between economic sustainability performance and environmental and social performance, indicating a relationship between the corporation’s economic value and its capacity to create value for society. This is consistent with shared value theory and stakeholder theory, emphasizing the need for ESG information disclosure to all stakeholders as a key element in establishing a competitive edge and enhancing company sustainability performance (Alsayegh et al., 2020).

The empirical outcomes derived from a research work reveal a notable correlation between ESG and financial performance, specifically ROE. Nonetheless, there is no substantial association found between ESG and operational performance measured by the ROA as well as market performance (Tobin’s Q) (Buallay, 2022).

Garcia et al. (2017) found evidence pointing to a curvilinear association, resembling an inverted U-curve, between a firm’s systematic risk and its ESG performance. This suggests that there is a threshold of systematic risk for the firm at which ESG performance is at its best. This realization emphasizes the need for regulators and investors to tackle systemic risks. If investors continue to ignore systemic concerns related to issues like social inequality, climate change, and working conditions in underdeveloped countries, they are essentially sending the message that these risks are irrelevant.

Generally, ESG disclosures exhibit a positive correlation with both ESG performance and firm performance. The risk-adjusted performance of socially responsible investment funds and indexes is statistically indistinguishable from those of conventional funds and indexes. The practice of excluding “sin industries” from investment portfolios appears to incur a financial expense. A strong and negative causal relationship exists between ESG disclosure and various types of financial risk (systematic, idiosyncratic, default, etc.), evident across diverse markets and asset categories.

The negative financial consequences of corporate social irresponsibility far outweigh the financial benefits of corporate social responsibility in the financial impacts of ESG disclosure. The degree of nonlinearity, if any, and the nature of the relationship between ESG disclosure and financial success, whether linear or nonlinear, are still unknown. Critical company choices, such as executive salary and merger and acquisition plans, appear to be influenced by and influenced by ESG (Brooks & Oikonomou, 2018).

Xie et al. (2019) undertook a study to determine whether companies that prioritize ESG issues can also achieve efficiency and profitability. The study’s goal was to explore the relationship between corporate competency and sustainability. The findings show a positive correlation between corporate transparency and efficiency, especially at moderate levels of disclosure as opposed to extremely high or low ones. Comparing the disclosure of information relating to social and environmental issues with the disclosure of governance-related information, the latter shows the strongest correlation with corporate effectiveness. The results indicate that the majority of ESG activities have a positive or neutral relationship with financial performance and offer new perspectives on the strategic decisions that businesses undertake to increase their overall corporate sustainability.

According to Duque-Grisales and Aguilerar-Caracuel (2021), there is a bad correlation between ESG scores and a company’s financial performance. This relationship’s negative sign suggests that companies with higher ESG scores typically have poorer profitability. Several Factors might contribute to this phenomenon. Firstly, it is possible that the costs associated with implementing ESG initiatives are not being effectively integrated into a company’s FP, either due to improper implementation or insufficient institutional support, which fails to make these efforts more visible and garner stakeholder approval. Alternatively, when firms make substantial investments in ESG, they could be diverting resources away from their core operations, impacting their cash flow and overall performance. It is interesting to note that the study...
also demonstrates how organizations can improve their financial performance by implementing stronger environmental and governance policies when there is a high level of governance and institutional development (GID).

A focus on social responsibility and environmental stewardship, when combined with a robust corporate governance framework, can serve as key drivers for comprehensive value creation. Additionally, factors such as a company’s size and the availability of surplus resources, which can be managed responsibly to enhance stakeholder control, play pivotal roles in this process. In essence, the study suggests that while both internal and external growth strategies may not yield immediate improvements in overall performance, companies can enhance their market and financial performances through a favorable adjustment attributed to their commitment to ESG principles. This positive effect is also applicable, albeit to a lesser extent due to limited available resources, to smaller companies that choose to expand. In a broader context, the benefits of integrating ESG considerations when looked at through Integrated Reporting (IR), into a company’s practices are likely to be even more pronounced (Tallentire et al., 2019).

Wong et al. (2021) make a significant contribution to the ongoing global discussion and investigation of how an ESG grade affects a company’s valuation. They analyzed Malaysian publicly listed companies that received ESG ratings between the years 2005 to 2018. The outcomes reveal a notable reduction in a firm’s cost of capital, averaging at 1.2%, along with a significant increase in Tobin’s Q, which rose by 31.9%, following the acquisition of an ESG rating. These results underscore the advantages reaped by stakeholders when companies actively pursue socially responsible investment (SRI) or ESG initiatives. Given the beneficial effect of ESG certification on a firm’s overall value, this should also serve as motivation for activist investors and ethical investment practices. Based on these findings, regulators may want to count obligatory ESG information disclosure as a policy instrument. Additionally, their findings imply that the equity market is more open to the adoption of ESG ratings than the debt market is. This suggests that the importance of ESG disclosure in corporate loan decisions may not be as high as it is in equity-related decisions.

Cavaco and Crifo (2014) emphasize how important it is to comprehend the various socially responsible practices’ characteristics within the context of the interaction between social responsibility and financial performance as complementary or substitutable practices. In particular, it is thought that human resources and business conduct toward customers and suppliers are relative complements of each other while the environment and business conduct toward consumers and suppliers are thought to be relative substitutes. For a corporation to achieve long-term financial performance, its connections with key stakeholders are essential. While some parties involved may disagree, others might have common interests. The new stakeholder perspective holds that “business” stakeholders, such as investors, employees, customers, supply chain partners, unions, or regulatory agencies, cooperate with the firm voluntarily, contributing to its operations to reach a win-win conclusion. A study done by Lee et al. (2016) shows a strong correlation between the environment-related duties of a business and the success of financial and operational practices at the corporate level. Their findings imply that corporates may simultaneously drive great environmental and economic performance. It becomes clear that businesses are better able to demonstrate significant environmental responsibility when they systematically monitor and assess environmental management and performance, effectively integrate this function within their operations, and allocate resources to strategic planning processes. An organization’s commitment to environmental responsibility can be fully fulfilled at the corporate level with functional integration and the deployment of suitable resources. Achieving optimal ESG performance concurrently can be difficult in situations where trade-offs must be made.

The results show that business sustainability does not significantly affect financial performance when looked at as a whole. When examined, corporate sustainability has both good effects on key financial performance indicators, such as return on assets (ROA), profit before tax (PBT), and growth in total assets (GTA), as well as negative influences, such as return on equity (ROE) and return on capital employed (ROCE). Additional analysis was done to better understand the individual effects of each sustainability component on a company’s financial performance. This analysis shows that all sustainability components, except for the community aspect, namely the governance, environment, and employees, show a significant but variable relationship with financial performance. Financial performance is favorably impacted by the governance and community dimensions but negatively impacted by the employees and environment dimensions (Aggarwal, 2013).

The results of a study conducted by Mervelskemper and Streit (2017) show that regardless of the specific report type chosen, whether it is a stand-alone or integrated report, whether or not a company chooses to report on ESG activities, determines how much investors value that company’s ESG performance. To be more specific, the publication of any ESG report, in whatever form, not only appears to increase investors’ capacity to evaluate and price ESG activities favorably but it is also correlated with a higher level of value proposition regarding ESG disclosures. This discovery is crucial because it clarifies the contradictory findings of earlier empirical investigations on the value-relevance of ESG performance. The market valuation of a company’s overall ESG and corporate governance performance can be further amplified by the publication of an integrated report, and this effect is both economically and statistically significant without adding any more expenses. This finding implies that, when compared to a standalone ESG report, IR is more effective at articulating how strong corporate governance positively promotes market value. Therefore, it can be said that IR is more effective at delivering improvements in the market valuation of ESG performance, outperforming stand-alone ESG reporting.
4.3. Role of CEO/board/gender and the impact of ESG

ESG disclosures potentially boost business value by encouraging accountability, openness, and greater stakeholder trust. Furthermore, when the CEO’s power within the organization is higher, a stronger correlation between the level of ESG disclosures and the value of the firm is seen. This shows that investors consider ESG disclosures from companies with powerful CEOs to be an indication of greater dedication to ESG standards. Numerous studies have demonstrated that the CEO’s power can greatly affect the organization’s information and transparency practices (Li et al., 2018).

When delving into the impact of gender diversity on corporate boards on ESG disclosure, studies investigate the influence of female directors on the commitment of a firm towards social responsibility practices. The research provides empirical evidence regarding the feminization of boards, not solely from the perspective of gender equality and organizational fairness but also considering its effects on overall governance and performance as well as providing a strong and positive correlation between ESG disclosure and the presence of a significant proportion of women on boards, sufficient to counteract any tendencies toward gender invisibility. When two, three, or more women hold board positions, they function as active minority influencers, shaping the rules, procedures, and practices of the organization. Consequently, companies tend to exhibit higher levels of ESG disclosure, thus reinforcing the positive relationship between gender diversity on the board of a company, transparency, openness, and CSR commitment. The study done by Manita et al. (2018) illustrates that the connection between women on corporate boards (WOCB) and ESG disclosure is subject to moderation and mitigation by factors such as passive minority presence and active minority strategies.

Birindelli et al. (2018) demonstrate that having a diverse board of directors has a favorable impact on a bank’s ESG performance, but then this impact decreases as the percentage of women on the board rises. As a result, they support the “dual critical mass” viewpoint and call for boards with an equal proportion of male and female directors. They also stress the importance of other board attributes, such as board size and the existence of a CSR committee, in enhancing a bank’s ESG performance. In contrast, there is a negative association between board independence and ESG success.

The intensity of a company’s GHG emissions and its carbon reduction initiatives (CRI) were two dimensions of its carbon performance that were the subject of one study that looked at the impact of board independence, board gender diversity, and sustainable CEO compensation. The findings of this research reveal several significant associations starting that the relationship between board independence and CRI is favorable. This affirms the idea that a nonpartisan board can effectively perform oversight and resource supply tasks, improving CRI. The study also discovered a favorable relationship between CRI and board gender diversity. This is in line with the idea that a diverse board may significantly influence how resources are allocated, encouraging CRI. The study also reveals that the policies for sustainable executive compensation show a good relationship with CRI. This is consistent with agency theory, which contends that reward-based incentives can encourage top management to participate in climate protection activities, hence enhancing process-oriented carbon performance. However, the study finds no evidence of a connection between executive salary or board features and GHG emissions. This unexpected result reveals that corporate governance processes frequently focus company’s carbon performance while attempting to improve performance without a corresponding decrease in actual GHG emissions (Haque, 2017).

4.4. Impact of ESG on the financial sector

When compared to the materials, consumables, and utility sectors, the financial sector emerges as the one with the lowest transparency in social disclosure scores, particularly when considering transparency disclosures across various industry sectors, particularly in relation to polluting and “sinful” industries. These sectors, which include companies like chemicals, metal mining, alcohol, tobacco, and utilities for gas, electricity, and water, have the highest average social transparency scores, which is surprising. This study also highlights the impact of governance-related concerns on ESG disclosure scores. Companies with larger and more gender-diverse boards of directors often have higher ESG scores, according to past empirical studies on this subject. Contrary to other research that asserts that separating the roles of CEO and chairman of the board promotes transparency, this study shows that companies with dual CEOs have higher ESG disclosure scores. It appears that CEO duality does not always result in less transparency when it comes to non-financial ESG data, in contrast to how it could affect the openness of financial information (Tamimi & Sebastianelli, 2017).

The pursuit of social and environmental sustainability has become one of the financial markets’ most important trends during the past ten years. A study underscores why financial institutions should actively engage in this endeavor, especially if they aim to enhance their business performance, particularly their financial performance. The findings are clear that when access to finance is accounted for, banks’ ROE is notably impacted. The same holds true for environmental financing. Essentially, by intensifying their focus on and improving practices related to access to financing, banks can expect an improvement in their financial performance. According to the study, smaller banks tend to have a more significant impact on profitability in terms of financing availability. Notably, compared to larger banks with higher total assets, smaller banks that have total assets below a threshold are significantly impacted. In essence, when taking part in efforts aimed at facilitating access to credit, smaller banks might have a bigger impact. Being that environmental financing lacks statistical significance in both small and large banks, it is important to note that distinctions in bank size do not appear to matter when it comes to this topic. As a result, with an emphasis on banks specifically, this study gives...
market investors and analysts a better knowledge of how social and environmental sustainability affects a firm’s overall performance (Nizam et al., 2019).

The research by Brogi and Lagasio (2019) dives deep down into the connection between ESG factors and company performance within U.S. corporations. Interestingly, the findings reveal noteworthy disparities between the sample of banking institutions and that of industrial companies, particularly in terms of the significance of the environment-related factors within the total ESG score. Intriguingly, the environmental score (E) within the banking sample displays a pronounced significance and a positive correlation with the banks' performance, as gauged by their ROA. Furthermore, the analysis demonstrates that the relationship between the ESG score of banks and ROA is more robust when considering ROA in the subsequent period (ROA$_{t-1}$) compared to the first period (ROA$_t$). This suggests that the adoption of a robust environmental policy within a bank may not only enhance its profitability in the short term but also have a lasting positive impact on its long-term financial performance. There are no appreciable variations between developed and emerging Europe in terms of the ESG composite score. When comparing ESG combined across Eurozone and non-Euro nations, they came to the same conclusions.

4.5. ESG and cost of capital

Eliwa et al. (2021) indicate that companies can reap advantages by enhancing their ESG performance and levels of disclosure, leading to reduced capital costs imposed by lending institutions. These results imply that the actions of lending institutions, acting as representatives of market forces, initially play a significant role in enhancing the importance and trustworthiness of ESG performance and disclosure, thus contributing to sustainable development. Specifically, their findings suggest that the influence of ESG practices on debt costs is more prominent in countries with a strong stakeholder orientation, where community engagement is more prevalent. This, in turn, suggests that civil society may consider ESG practices as a viable instrument for instigating changes in business conduct.

Hussain et al. (2018) discovered that the choice of sustainability performance (SP) measurement is a crucial factor that can yield more conclusive results regarding the relationship between sustainability engagement and firm performance. The study also sheds light on the segmentation of SP dimensions, emphasizing the necessity for a reassessment and realignment of these dimensions. Their findings demonstrate that, regardless of the extent of disclosure, the actual impact by the responsible investment reporting initiative can only be realized through substantial dedication to sustainable development objectives. These findings are very consistent with stakeholder theory. The findings support the Porter hypothesis which shows that a sincere commitment to corporate sustainability yields positive effects. Additionally, they conclude that businesses that invest more in sustainability, particularly those with a high level of visibility in this field, generally outperform their competitors.

The ESG elements should be considered by investors when evaluating a company’s performance, according to the United Nations Principles for Responsible Investment (UN PRI). A diverse range of stakeholders including environmental organizations, investors, creditors, and governing bodies, place a high value on firms’ contributions to sustainable development in the context of their business environment. In response to these concerns, a study undertaken in reaction to these changing dynamics found that there is not a strong relationship between individual or collective ESG characteristics and measures of business value like Tobin’s Q or indications of company profitability like ROE. It is important to note that a company’s weighted average cost of capital (WACC) has a direct and significant impact on the combined ESG score. This has ramifications for the company’s valuation in turn (Atan et al., 2018).

4.6. Investment decisions and ESG

To satisfy their fiduciary obligations and match their interests with more general social goals, all rational investors should place a high priority on adopting a long-term responsible investing approach. To realize the full value-enhancing potential of ESG elements, this goal requires a thorough and in-depth understanding of how to incorporate ESG criteria into investment processes (Friede et al., 2015). The importance of ESG data to investment performance is the main driving force behind its use, closely followed by customer demand, product strategy, promoting organizational change, and ethical issues. The lack of reporting standards, which results in a lack of comparability, dependability, quantifiability, and timeliness, is one of the noteworthy obstacles preventing the usage of ESG data. The survey also shows that when using ESG data, the majority of investors are motivated more by financial than by ethical considerations. The majority of the time, according to the respondents, ESG data affects investment performance. However, the importance of a particular ESG indicator is probably systematically different across nations with different ethical or environmental concerns, industries with distinct concerns about climate change or human rights, and even firm strategies using various business models (Amel-Zadeh & Serafeim, 2018).

Particularly with regard to the objectives of socially responsible investors, the relationship between SRI, regulation, and the assessment of extra-financial performances is important. Many conventional fund managers have incorporated elements of responsible investing into their investment processes. There are several ways in which fundamental investing and ESG investing are comparable and responsible investment is significantly impacted. The portfolio manager location also US-based managers are more or less skeptical of its benefits, while European managers are unduly hopeful (van Duuren et al., 2016).

Muñoz et al. (2014) cite the fact that more and more investors have started considering the practices adopted by the firms in the area of ESG while making investment decisions. For instance, green funds allocate their investment capital to businesses with proven environmental track records. There are solid arguments to support the notion that
great financial performance is favorably correlated with superior environmental performance, despite the initial perception that environmentally conscious businesses incur higher costs for internalizing their environmental impact. The results of this study show that, in comparison to other kinds of socially responsible mutual funds, green funds do not underperform. Even after taking into consideration times of market crisis, this conclusion is still valid. The lone exception is seen in the case of green US global funds, which perform much worse than their conventional equivalents. When evaluating financial performance amid market crises, this underperformance disappears, nevertheless.

Sustainable and responsible (SR) investments emphasize the idea that each investment should follow the ethical ideals of the SR investor. The distribution of SR investments to businesses with higher ESG standards depends in large part on the evaluation of ESG scores provided by rating agencies. The results show a strong positive correlation between these factors, which may be explained by the idea of organizational legitimacy. These results raise the question of whether the methodology used by ESG scores to assess corporate sustainability favors larger companies with more resources while potentially depriving SR investors of the knowledge they need to make decisions in line with their principles (Drempetic et al., 2020).

The effectiveness of an ESG-based investment strategy is heavily influenced by geographical and industry considerations, as well as the specific ESG criteria utilized. When applied to the Asia-Pacific region and the US, the selection of low or high ESG stocks does not consistently result in improved or decreased performance in comparison to benchmarks or alternative ESG stock choices. Similar findings are observed in Europe, where the superiority of ESG-focused strategies is not evident. Instead, the instances are uncovered within certain industries and ESG criteria where socially responsible stock selection may lead to diminished risk-adjusted performance compared to passive benchmarks. This underscores the notion that aligning with ethical principles in stock selection might come at a cost in some scenarios. Given that private investors generally gauge investment fund performance against broad market indices, the results have very sound implications for the formation and promotion of ethical funds. The fund managers can cater to the ethical preferences of the clients through ESG-driven stock selection, while at best achieving performance on par with the broader market. However, this holds true for the Asia-Pacific region and the USA, regardless of the specific ESG criterion or industry focus. In contrast, European investors should be cautious about certain combinations of ESG criteria and sectors to avoid potential financial setbacks. It is important to note that ESG-based stock selection might not be sufficient to fulfill the objectives of profit-seeking investors, whether they choose socially desirable or less desirable stocks (Auer & Schuhmacher, 2016).

4.7. Time horizon as moderator

Another study investigates whether the time horizon of investors can be used as a basis for categorizing these groups, bearing in mind that theories related to ESG investing are built on the assumption of distinct groups of investors driven by differing interests in ESG, either due to their personal preferences or financial motives. With a focus on both mutual funds and institutional investors, the findings provide a solid foundation for the existing theories. The study finds a positive correlation among socially responsible managers, as they often need to source data from external providers, including various ESG rating agencies. Notably, there is often little correlation between the ESG ratings assigned to a particular stock by different agencies. Therefore, it is essential not to treat ESG ratings as a one-size-fits-all solution or apply them mechanically. Using ESG scores across the board is not the answer. From the perspective of long-term investors, there is no conclusive evidence that ESG screening significantly enhances expected returns or reduces risk. This holds true whether the performance of companies is assessed based on their ratings or ESG funds or indexes. However, there is also no compelling evidence of significant underperformance. For ESG investment strategies that involve exclusions, both theory and the available evidence suggest that ESG investors may experience a modest reduction in expected returns and some minor diversification impact. In essence, the price of adhering to ethical principles appears to be relatively small, and many socially responsible investors may find it acceptable.

According to Ng and Rezaee (2020), while making investments, whether voluntary or not, investors usually consider the elements connected to ESG sustainability performance and transparency. A higher stock price informativeness (SPI) is probably caused by these reasons. By focusing on their effect on idiosyncratic volatility, the study first investigates whether ESG sustainability performance indicators have an impact on SPI. It concludes that ESG sustainability performance parameters are associated with greater SPI even after accounting for economic success, demonstrating that the stock market takes these concerns into account when valuing businesses. The study also looks at the relationship between voluntary ESG sustainability disclosure and SPI given that sustainability information is already voluntarily revealed to investors. According to the findings, optimal ESG sustainability disclosure levels may not have a direct impact on SPI, but they do increase the connections between SPI and voluntary ESG sustainability performance variables. The study delves deeper into how economic performance affects the relationship between ESG sustainability performance, disclosure variables, and SPI. It should be highlighted that when the economy is doing poorly, this link is more visible. This implies that when firms demonstrate worse financial economic performance, investors tend to favor sustainability performance and disclosure considerations, underscoring the paramount importance of economic performance in investor decision-making. In light of these findings, it is recommended that corporate reporting be standardized, and non-financial ESG sustainability dimensions be included.
association between investors’ time horizons and their propensity to hold a higher percentage of high-ESG-rated stocks in their portfolios through our analysis, both at the investor level and the firm level. Additionally, it was seen from cross-sectional analyses that firms with stronger ESG credentials typically draw investors with a longer average horizon for their investments. These results persist over time as long-term investors steadily raise their preference for stocks that show notable ESG profile improvements. The study looked at three possible ways that investor time horizon may affect institutional ESG preferences. First off, long-term investors show a specialization in obtaining and interpreting ESG-related information, which causes them to choose high-ESG equities in the information channel. On the other hand, short-term investors favor higher-frequency signals more. Second, firms with good ESG profiles can produce value over the long term within the limits-to-arbitrage channel because their managers are less concerned with short-term swings in investor flows and are more resilient to short-term performance failures, long-term institutions are better-positioned to take advantage of such opportunities. Finally, long-term institutions modify their portfolios toward high-ESG stocks in the clientele-catering channel to suit the preferences of their final investors (Starks et al., 2017).

4.8. ESG in unprecedented times

The research done by Broadstock et al. (2021) investigates the significance of ESG performance amid a widespread financial crisis because of the global COVID-19 pandemic breakout. These distinct circumstances offer a unique chance to explore whether investors perceive ESG performance as an indicator of forthcoming stock performance or risk management. The study suggests that portfolios with strong ESG characteristics tend to outperform those with weaker ESG traits. ESG performance helps alleviate financial risk during times of crisis, and its impact becomes less pronounced during typical periods, highlighting its heightened relevance during crises.

Despite the prevailing belief that ESG scores act as indicators of stock price resistance, the research provides compelling evidence to the contrary amidst the pandemic. After adjusting for industry affiliation, market-derived risk metrics, and accounting-based assessments of performance, financial health, and investments in intangible assets, they find that ESG does not possess the anticipated capacity to explain returns during the COVID crisis. In contrast, they observe that a metric representing a company’s accumulation of internally generated intangible assets serves as a robust, statistically significant factor positively influencing returns (Demers et al., 2021).

Manrique and Marti-Ballester (2017) researched that financial performance is largely impacted by the implementation of environmental initiatives. Neoclassical economic theory contends that the adoption of environmentally friendly procedures could result in higher production costs and a consequent drop in profitability. However, the instrumental stakeholder theory argues that by reducing environmental risks, integrating environmental practices into a company’s fundamental business plan can result in cost savings. Additionally, this strategy improves ties with significant stakeholders, which ultimately results in competitive advantages and sustained increases in the financial performance of the company. Their research focused on how business environmental performance affects financial performance while taking the nation’s economic development level into account. According to their findings, businesses that increase their corporate environmental performance typically have better financial performance during economic downturns. However, compared to businesses in wealthy nations, this effect is more evident for companies operating in emerging and developing nations. One argument is that developing and industrialized nations have different environmental strategy implementation processes. Companies in less developed nations may be only beginning to embrace environmental practices, concentrating on simple, affordable improvements. In contrast, businesses in developed nations might be well along the way and are more likely to spend on environmental projects. Government funds are frequently curtailed during economic downturns, and consumer demand for goods also declines..stil might make managers in rich nations with limited capital unwilling to finance pricey and possibly risky environmental projects. Due to the economic crisis, customers could be unwilling to pay higher prices as a result of these investments. As a result, this may affect immediate advantages and affect investors’ expectations of a protracted financial crisis. Corporate environmental performance and financial performance are influenced by a number of additional factors, such as firm size, resources available, debt levels, R&D spending, capital investments, growth rate, market share, industry, and region.

4.9. ESG ratings

Amidst the growing adoption of ESG ratings, there exists a significant divergence among rating agencies in assigning ratings to individual companies. Given the uncertainty surrounding the factors driving this variance, there was one study that investigated whether a firm’s ESG disclosure can shed light on this phenomenon. The research aimed to ascertain if a company’s level of ESG disclosure contributes to explaining some of the observed discrepancies in ratings across agencies. The study subsequently confirmed that increased ESG disclosure by a firm correlates with a higher degree of divergence in ESG ratings. The analysis demonstrates that raters exhibit greater discrepancies in assigning ESG ratings for outcome metrics compared to input metrics, the policies. Interestingly, the effect of disclosure on exacerbating discrepancies appears to be more pronounced for outcome metrics. In their investigation of the ramifications of ESG rating disagreement, they discover that heightened disparities in ESG ratings are linked to greater return volatility, larger fluctuations in stock prices, and a decreased likelihood of pursuing external financing. In essence, the findings underscore that rather than mitigating differences in ESG ratings,
increased ESG disclosure tends to amplify these divergences (Christensen et al., 2021). Billio et al. (2021) analyzed the ESG rating criteria employed by leading agencies, revealing a notable lack of consensus on how these agencies define ESG factors and standards for the categorization of E, S, and G components. The research demonstrates that this divergence in rating criteria can result in agencies forming opposing assessments of the same companies, leading to significant discrepancies in their evaluations. Furthermore, there is also a startling lack of agreement among these suppliers. These many ESG criteria have a big impact on sustainable investments that lead to the discovery of various investment avenues and the development of unique thresholds. As a result, when financial outcomes are significantly influenced by the selected ESG benchmark, it becomes extremely difficult to evaluate a fund manager's performance in the asset management sector. Additionally, their data suggest that the impact of ESG investor preferences on asset prices is dispersed due to disagreement in the ratings supplied by rating organizations. Even when there is agreement, financial performance may not be greatly impacted in some circumstances.

When it comes to providing the ESG scores by various agencies, their methodologies are also important aspects that need to be discussed. In the same quest a study was done, and attention was given to distinct ESG dimensions in this. Additionally, the research incorporates an aspect of risk. Notably, the paper marks the attempt to investigate ESG risk as characterized by a downward variation in scores over time. This aspect holds special significance for investors and aligns with contemporary portfolio selection techniques that rely on both financial and non-financial data. The findings indicate a noticeable absence of convergence in ESG assessments. First off, a qualitative comparison of several scoring methods reveals wide variations in the methods used to calculate scores and even in the notion of social responsibility. These differences lead to variances in the level of transparency as well as the complexity of evaluating CSP. Second, descriptive statistics show that the scores supplied by the three ESG rating firms differ from one another. Larger companies frequently get higher scores, which is probably due to their expanded reporting activity. The ESG risk analysis also highlights how the underlying data source has a significant impact on predicted losses. As a result, there is little connectivity between the many datasets related to ESG risk (Dorfliehtner et al., 2015).

The analysis done by Gibson Brandon et al. (2021) underscores the importance for financial analysts evaluating firms' equity to consider the influence of ESG rating discrepancies. They should adjust their estimates of equity cost of capital upward to reflect this disagreement. Secondly, chief financial officers (CFOs) tasked with deciding on capital expenditure allocations should also factor in ESG rating discrepancies when making capital budgeting decisions. This is particularly crucial for firms, facing significant total (and environmental) rating discrepancies, as it raises the investment threshold. Thirdly, financial analysts who typically focus on particular industries will find the variety in ESG rating discrepancies among industries to be a significant source of information. Finally, their approach has important implications for asset owners and investment managers putting ethical investment practices into practice. Screening and ESG integration are two tactics that are currently in demand in the world of responsible investments. Asset and investment managers should pay attention to ESG rating differences and their effects on stock returns to maximize financial performance while following responsible investment standards. When screening is positive, investors should primarily purchase equities that, given a high ESG rating, have the lowest level of ESG disagreement and sell those that demonstrate the largest disagreement.

According to research done by Singal (2014), firms in the hospitality and tourism sectors typically tend to get higher overall environmental scores than businesses in other sectors. This emphasizes the importance of environmental reputation for hospitality firms, especially in their attempts to draw in a wide range of clients, including those who prioritize an eco-friendly environment. This study strengthens the fact that a firm’s commitment to socially responsible activities is positively influenced by having financial resources, sometimes known as organizational slack. In essence, it concludes that having great financial performance provides a platform for actively participating in socially responsible activities, a trend seen across numerous industries, including the hotel and tourism sector. The study specifically shows that organizations that perform better financially, as seen by higher credit ratings, also score higher in terms of environmental sustainability.

A study done by Halbritter and Dorfliehtner, (2015), using ESG ratings, looks at the relationship between social and financial performance of business. They claim that while previous research suggests a link between ESG rating levels and returns, their examination objectively assesses a number of issues. It is crucial to do this analysis utilizing several ESG datasets to fully address some of the concerns. According to the outcomes of ESG portfolios, there are no appreciable differences in returns between businesses with high and poor ESG rating levels. This is valid for both overall scores and particular ESG pillars. These results hold true when considering various portfolio cut-offs and weightings.

4.10. ESG and risk

The influence of social and governance factors on the level of market-based risk within European companies was analyzed with three distinct risk measurements: systematic, idiosyncratic, and total risk and the findings reveal that heightened CSP correlates with a reduction in both total and idiosyncratic risk. It was discovered that social performance has a big, bad effect on all three risk measurements. Environmental performance primarily contributes to a decrease in idiosyncratic risk, while total risk and systematic risk are mostly affected in industries that are sensitive to the environment. However, Sassen et al. (2016) were unable to find a significant connection between corporate governance performance and firm risk. The results from their investigation indicate that enhanced CSP,
particularly in the realm of social dimensions, holds the potential to lower firm risk and consequently bolster firm value. Their findings lend credence to the idea that embracing corporate social responsibility could indeed yield tangible benefits for businesses, forming a compelling argument for its adoption.

Many previous studies have focused on figuring out the relationship between firms with strong ESG traits and their financial performance as an organization. However, it has been difficult for these efforts to demonstrate definite connections that fully explain behavior consequences. They built a connection between ESG data and its impact on company performance and valuation in a study they conducted. This is accomplished by examining three independent pathways — the cash-flow channel, the idiosyncratic risk channel, and the value channel — within a traditional discounted cash-flow model. The findings of this study show that factors like a company’s systematic risk profile and idiosyncratic risk profile are used to communicate a company’s ESG information to both its valuation and performance. As a result, the study suggests that changes in a company’s ESG characteristics might be useful as financial indicators (Giese et al., 2019).

4.11. Press news and ESG

Data on how corporations address issues of corporate governance, social responsibility, and the environment are now accessible to investors and analysts in a way that has never been possible before. To boost financial performance and reduce risks, corporate executives must take these CSR considerations into mind. It is clear that negative ESG news primarily, if not entirely, causes shareholder reactions when it comes to shareholder reactions. A company’s market value typically decreases by 0.1% over a three-day period when unfavorable ESG news is disclosed. Contrarily, good ESG news hardly ever has a statistically significant impact. However, the negative effects of these unfavorable ESG events can be mitigated if the companies in question had previously reported more positive ESG information than their industry rivals and if the sector as a whole has a strong ESG reputation. On the other hand, this loss tends to be amplified when the news is accompanied by quantitative and economic data and there is an emotional connection between the event and the company (Capelle-Blancard & Petit, 2019).

As per Aouadi and Marsat (2018), ESG controversies surprisingly show a significant, favorable impact on a company’s market value. The direct impact of ESG controversies completely disappears when the interaction term between controversies and the CSP score is contemplated alongside the CSP score. The interaction term itself has a positive and notable relevance. Their conclusions only apply to high-attention enterprises, which include those with greater size, superior performance, increased investor attention, or locations in nations with higher press freedom.

As per Tarmuji et al. (2016), stakeholders are precisely aware that a company’s ESG duties are essential to its performance and long-term viability in today’s increasingly interconnected global economic landscape. Numerous studies show that the ethical handling of ESG concerns promotes a corporate culture and environment that improves a company’s reputation in the community and increases stakeholder trust. As a result, businesses that openly share their ESG practices across a variety of media outlets are perceived as improving, which boosts investor confidence. They are then able to deploy resources more effectively and keep up their competitiveness as a result. The results of this study provide important new information about how ESG practices affect business success in Malaysia and Singapore. The study’s significant and favorable association between environmental practices and economic performance in both countries is one interesting finding and they also found that corporate environmental policies have no statistically meaningful impact on Singapore’s or Malaysia’s economic success whereas corporate governance procedures have a big impact on the economic performance of Malaysian companies and the social practices have a large impact on companies’ financial performance in Singapore. The study shows that implementing environmentally friendly methods is known as “going green”, subsequently improves overall performance in businesses. This effect is especially noticeable in the hospitality and tourism industries, highlighting how establishing a solid reputation may greatly improve a company’s performance. This situation emphasizes the symbiotic relationship between reputation and performance by showing how investments in environmental sustainability have an impact on a company’s credit ratings.

5. CONCLUSION

The ESG reporting and disclosure has been a very recent development in the context of business and that too when many do not consider climate change or environmental degradation a problem to be worried about till now. The way the regulatory bodies are trying to tighten the business practices to reduce the harm to the climate, the corporate bodies need to be in sync with the ESG principles.

This study is also an attempt to compile the work of all the researchers done in the area of how ESG reporting is affecting the firm’s reputation and performance in an era where the consumer, investors, and other important stakeholders are looking at the environment, society, and governance very seriously and may be on their priority list of interests, these come before the economic profits or economic gains.

The study has tried to gather a summary of highly cited research work because summarizing all the research findings will be impossible keeping in mind the length of the paper. The implication can be seen like this study has shown that the area of ESG reporting can also be categorized from various perspectives, for example, investment, the stock market, and the cost of capital perspective. The other implication is to see that the way ESG reporting is being made compulsory gradually and the different bodies in different parts of the world are trying to put across the framework for the adoption of ESG reporting, it is not far off that this will become one of the compulsory disclosures and hopefully, the audit is going to be the second phase of the development in this field.
Another implication of this study is that the researchers can get an idea of the areas where the research has been conducted and the journals that publish the research in the area of ESG disclosures. The keywords analysis has also been done and looking at the combinations of the words, new areas of research can be found by the researchers.

The research is based on the data collected from the databases viz. WoS, Scopus, and the Google Scholar. More databases could have been taken but due to the time and the data size involved, we limited ourselves to these 3. More research papers could have been part of this study but due to the length of the paper, we restricted our SLR to include only the top cited papers, and that too with 125 or more citations which is quite high.

Further research can be done in the areas we have covered separately. The researchers can refer to the literature and take one area like ESG reporting and its impact on the financial performance of firms based on book indicators like ROE, ROA, Tobin’s Q, and so on, and can do the SLR of all the research work done in that area. Also, the area of how the ESG practices are being reported and whether the reporting has been institutionalized or not, and if institutionalized then how are the practices being implemented and monitored, is going to be an area which will require more research to be done.

REFERENCES


