The Impact of ESG Performance on Corporate Value

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Abstract. As environmental problems have been increasingly serious, the concept of "sustainable development" has gradually taken hold. ESG, which reflects a company's sustainable development capabilities, has become a trend and attracted widespread attention in the academic community. However, there is still a lack of a unified understanding of the specific association between ESG and corporate value. This article analyzes literature in the international financial field related to ESG in recent years and explores the way ESG influences corporate value from the perspectives of impact, influencing mechanism, and heterogeneity. The aim is to provide insights into future research directions in this field. This article found that there are three impacts of ESG performance on corporate value: promotion, inhibition, or irrelevance. ESG performance mainly affects corporate value from four aspects: financing constraints, green innovation, corporate efficiency, and corporate risk. The heterogeneity of ESG performance mainly depends on factors such as property rights, marketization degree, information transmission efficiency, company size, and industry environmental sensitivity. Future research on ESG should be centered on empirical research that examines ESG's comprehensive influence and regional heterogeneity of ESG performance.

Keywords: ESG, Financing constraints, corporate value, Innovation-driven strategy.

1. Introduction

The term ESG, short for Environmental, Social, and Governance, was formally proposed by the United Nations in 2004. It is a new concept of sustainable development that underscores the coordination and development of society, environment and company governance. It is also a new evaluation standard for companies that emphasizes societal, environmental, and governance achievements rather than traditional financial performance. In the past decade, the high-speed economic growth has caused serious social and environmental issues, which now has aroused increasing social and environmental awareness and promoted continuous improvement of environmental laws and regulations. -The ESG concept has entered the vision of governments, individual shareholders, and institutional investors, and has attracted increasing attention [1].

As the cornerstone of sustainable development, ESG is receiving increasing academic attention [2]. There have been many academic researches, both theoretical and empirical, on ESG, especially on its association with corporate value. It is widely accepted that ESG performance can positively affect corporate value and companies' market valuation and business performance because good ESG performance can alleviate information asymmetry and agency problems, ease financing constraints, promote innovation, and enhance corporate reputation [3].

However, not all researchers support the argument of the positive influence of ESG performance on corporate value, and some even suggest that ESG performance impairs corporate performance [4]. Moreover, there is another assertion that ESG performance does not affect corporate value [5] at all. This reflects that the interplay between these two items has not yet reached a consensus in the academic community. However, exploring this issue is of great significance for the sustainable development of enterprises, high-quality economic development, environmental protection, and improvement of related institutional construction. This article selects relevant literature in the international financial field related to ESG to study ESG's influence on corporate value and the influence mechanism and heterogeneity of ESG. It summarizes the existing ESG-related literature and assesses the current research status of the interplay between these two items. The aim is to make marginal contributions to the improvement and practical application of ESG theory by exploring the research status of the interplay between ESG and corporate value and making judgments on future research trends.

2. The Impact of ESG on Corporate Value

In the past, studies exploring the impact of ESG on corporate value were usually started with one aspect like the environment, corporate governance, or social responsibility. However, with the emergence of ESG as an integral concept in recent years, a burgeoning literature has conducted comprehensive research on ESG performance to explore its impact on corporate value more comprehensively. However, there is no consensus on this issue.

2.1. Promoting Effect

Most researchers claim that ESG performance positively affects corporate value [6]. This includes, but is not limited to: Zhao et al. believe that companies can reduce their financial risks and improve their business performance by participating in ESG activities [7]; superior environmental, product, and service performance can give stakeholders a good impression towards the company, thereby increasing market value[8]; the stakeholder and value creation theory suggests that developing superior green products and investing in ESG can improve a company's fame in the market, promote its product sales, and enable it to set a higher price compared with competitive products, thereby having a positive impact on its financial performance [9, 10]; investing in ESG practices can improve a company's operational efficiency, improve its market position, and reduce capital costs, hence upgrading its financial performance [11]. Investment in ESG-related activities can help alleviate future regulatory litigation related to ESG requirements, by doing so, the potential burden on future cash flows can be reduced and a company's financial performance will be positively impacted [10].

From a large amount of research, it is clear that ESG performance can result in favorable consequences to companies' value, including corporate reputation, operational efficiency, financing costs, and product premiums.

2.2. Inhibitory Effects

However, based on neoclassical theory, some scholars, represented by Friedman, believe that advancing ESG performance may also have some negative effects on a company's value. Some studies suggest that internal company personnel often invest excessively in activities related to ESG for their own benefit, such as sacrificing shareholder value to improve reputation [12], which leads to a negative correlation between ESG performance and company value [13]. Another study argues that charitable activities that are beneficial to the environment and society as an ESG activity may pique the interest of senior executives but are generally not valued by investors, leading to a decline in company value [14]. This is also consistent with the theory of cost-related schools, which argues that ESG-associated activities have an adverse influence on corporate value [15] as they increase the burden of operating costs.

2.3. Irrelevant Effects

Some scholars have found no clear or definite association between ESG activities and company value. Atan et al. studied Malaysian companies, finding that ESG performance had no obvious influence on company value [5]. Landi et al. found that ESG performance did not bring excess returns to Italian companies because investors were not interested in ESG activities [16]. In addition, some studies have found a lagging phenomenon in ESG's impact on the business performance of enterprises. Researchers observe that environmental protection-related expenditures do not bring immediate profits, so ESG and short-term financial performance are not significantly correlated [17].

3. Mechanisms of the Impact of ESG Performance on Corporate Value

The uncertainty in whether ESG can affect company value raises questions about the necessity of ESG activities for companies. To provide theoretical support for companies to carry out ESG activities, we should analyze the mechanisms of how ESG performance affects company value.

3.1. Financing Constraints

ESG has the function of alleviating financing constraints, making it easier to obtain greater financial support from investors at lower costs. To begin with, ESG provides more corporate information to enhance corporate transparency. This helps to alleviate information asymmetry between investors and enterprises and reduce the information risks faced by creditors. - Moreover, the non-financial information it reflected is indicative of the future operating conditions, as a result ameliorating corporate images [18]. ESG can enhance the confidence of creditors, and effectively reduce the rate of risk return on investment demanded by creditors [19]. In addition, the ESG management system can help improve the quality of corporate governance and reduce agency problems [20], protecting the interests of investors. In summary, a firm with a more robust ESG performance tends to suffer fewer financing constraints, which further increases this firm's company value.

3.2. Green Innovation

To improve ESG performance, companies usually make green innovations. Especially, those having a better ESG performance are more likely to emphasize long-term interests and accordingly increase innovation investment, in turn enhancing capacities to sustain development. According to the theory of long-term value investment, companies with better ESG performance and stronger green innovation capabilities will receive higher quantitative investment returns [21]. In addition, as the authorities have been strongly promoting green finance policies in recent years, companies with strong green innovation capabilities are more likely to receive support from preferential policies [22].

3.3. Corporate Efficiency

Corporations will gain significant efficiencies by improving ESG levels. Firstly, enterprises having a strong ESG performance tend to possess a robust company management mechanism, which can effectively supervise and constrain management to ensure responsible management of the company, agency problems will be reduced and investment efficiency be enhanced as a result [23]. Secondly, companies that attach importance to sustainable development and social responsibility are more likely to win the favor of stakeholders, prompting stakeholders to play a more active supervisory role, thereby further improving corporate governance capabilities. Finally, enterprises having a strong ESG performance are more proactive in disclosing more financial or non-financial information to accumulate reputation capital, which helps reduce information asymmetry within and outside the company, ease agency conflicts, and improve corporate governance efficiency [24].

3.4. Corporate Risk

Companies with a strong ESG performance face a small operation risk. Firstly, ESG performance helps companies to maintain a sound reputation as companies that fulfill ESG responsibilities and have good ESG performance send more favorable signals to the market and have a greater appeal to investors, establishing a favorable corporate reputation and image. The market has a higher degree of tolerance toward enterprises with good reputation and image, and it is more inclined to regard negative events of such enterprises as a mistake or a random event on the part of the company [25]. Companies can rely on the trust and moral reputation of social capital accumulated through good ESG performance to alleviate the adverse impact of negative events on the company with smaller economic losses [24]. Secondly, good ESG performance represents a company's sustainable development capability under the premise of competitiveness, including the possibility and stability of a company's long-term development. In the face of external economic downturns, good ESG performance helps to increase stakeholders' confidence, effectively reducing the market risk of the company [26]. In addition, the ESG performance of companies often attracts market attention, and stakeholders supervise the enterprise's business behavior. Enterprises having good ESG performance pay attention to environmental protection, corporate governance, and other aspects and their business behavior is better regulated, reducing management risks and litigation risks [27].

4. Heterogeneous Analysis of the Impact of ESG Performance on Corporate Value

The massive studies on the mechanism of how ESG affects corporate value reflect substantial support for the idea that ESG performance has a positive impact on company value, and a range of factors affect the association between ESG performance and company value.

4.1. The Impact of Property Rights on the Value Effect of ESG

The motivation behind corporate ESG performance is influenced by the property rights of the enterprise. The property rights of the enterprise are an important factor that affects companies' ESG performance. Firstly, private enterprises take obtaining economic benefits as their fundamental goal, and improving ESG performance is predominantly for higher economic returns. They are more inclined to choose ESG activities that can bring greater economic benefits. However, state-owned enterprises are different as they bear greater social responsibilities and play the role of state intervention in the market. They are more inclined to respond to the national call and set an example by fulfilling their social responsibilities. Secondly, state-owned enterprises have an inherent obligation to support the national call and assume social responsibilities. Thus, stakeholders have a proper understanding of the ESG performance of state-owned companies, and they tend to hold lower expectations for the social responsibility performance of private enterprises. Once private enterprises perform well in ESG performance, the market's reaction to this unexpected performance will be greater. Thirdly, state-owned enterprises have long had problems with low vitality and efficiency, while private enterprises are more efficient under the driving force of economic benefits [19]. Finally, state-owned enterprises can always receive support from the government or state-owned banks. Private enterprises can obtain a higher marginal effect on obtaining government or state-owned bank support by improving their ESG performance [25]. In summary, good ESG performance often has a greater influence on private enterprises' corporate value.

4.2. The Influence of Marketization

Firstly, excessive government intervention in the market will adversely affect the ESG's influence on company value, because enterprises need to struggle to handle its relationship with the government, which leads to non-efficient expenditures on social responsibility and consequently impairs the positive role of ESG in corporate value. Secondly, the worse the legal environment, the weaker the positive effect of ESG performance on corporate value. The reason is that the poor legal environment weakens the authenticity of ESG information, and enterprises are not subject to significant punishment for behavior that is unfavorable to ESG performance [25].

4.3. The Influence of Information Transmission Efficiency

Firstly, when stakeholders more emphasize the company, the ESG performance will play a stronger role in corporate value, because stakeholders can play a supervisory role. Secondly, when stakeholders pay more attention to the company, information intermediaries will also more care about this company. The intermediaries can collect a large amount of information, process the complex announcement information of the enterprise into a simple and clear form, and help stakeholders better understand the company's ESG performance. Thirdly, the company that is more transparent in information disclosure will benefit more from the ESG performance. Besides, the higher ESG disclosure quality, higher information quality, and more information provided to stakeholders will help the company to gain more stakeholders' trust in the enterprise and better facilitate the conversion of ESG performance into higher corporate value. Collectively, if a company improves its information transmission efficiency, its ESG performance will have a better impact on its corporate value.

4.4. Impact of Enterprise Scale

For enterprises, small-scale enterprises need to acquire more resources for development by obtaining good non-financial information regarding ESG. The smaller the scale of the enterprise, the greater the marginal utility brought by its ESG performance [28].

4.5. Impact of Industry Environmental Sensitivity

The positive impact of ESG performance on enterprise value is more significant for non-polluting industries. For one thing, polluting enterprises face strict environmental constraints and require larger costs for environmental governance compared to non-polluting enterprises.

The ESG performance can play a better role in improving corporate value for non-polluting industries. First, polluting companies face strict environmental constraints and require larger costs for environmental governance compared to non-polluting enterprises. For another, stakeholders generally believe that improving the environment is the inherent responsibility of polluting enterprises, so the sensitivity of ESG performance for those enterprises is not high [19].

4.6. Impact of E, S, and G

Compared with social and environmental responsibilities, company governance plays a greater role in enhancing enterprise value as taking on environmental and social responsibilities incurs both direct and indirect costs, which reduces a company's competitiveness. In addition, due to various reasons, corporate management may excessively bear environmental and social responsibilities, causing damage to company interests [29].

5. Conclusion

This study comprehensively explores recent domestic and international research on the correlation between comprehensive ESG performance and company value, including theories, mechanisms, and heterogeneity. Most studies support the positive impact of good ESG performance on enterprise value. Mechanism analysis signifies that ESG performance enhances enterprise value by reducing financial restrictions, promoting green innovation, improving efficiency, and reducing risks. Further analysis reveals that the positive influence of ESG on corporate value is more remarkable for non-state-owned companies, companies located in more market-oriented regions, companies with higher attention and more comprehensive information disclosure, smaller-scale companies, and companies with lower environmental sensitivity.

Based on the existing research, the future research trends of ESG are as follows:

First, enriching theoretical and empirical research on the impact of comprehensive ESG information. The ESG theory is still in its development stage, as it is gaining more attention, relevant research has gradually increased. However, empirical studies in this field are still relatively scarce, and research perspectives are comparatively limited. Increasing research on the current situation and the impact of comprehensive ESG information, improving the theoretical system, and promoting the development of ESG-related theories have profound implications.

Second, increasing research on regional heterogeneity in the impact of comprehensive ESG information. Different countries or regions have differences in political systems, economic development, ideologies, and legal frameworks, which lead to varied impacts of ESG comprehensive performance on enterprise value. Conclusions drawn from investigations conducted in one country or region cannot be directly applied to another country or region. Research on these differences and causes can provide scientific theoretical guidance for practical activities.

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