

Environmental, Social and Governance (ESG) Phases and Circulation

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Abstract. With the increasing impact of environmental, social and governance (ESG) on the world, this paper aims to discuss the current situation of ESG applications in China and abroad, as well as the corresponding impact of ESG disclosure, rating and investment. Furthermore, the paper adopts a systematic review method to sort out related literatures in the field of ESG, and then discusses the interaction of the three parts and the cyclical role of the components. The discussion found that investors attach great importance to the ESG disclosure and rating, and more and more mainstream investors are incorporating ESG factors into their investment decision-making process. Moreover, ESG disclosure, rating and investment are complementary to each other. If an enterprise discloses ESG information well, it will receive a relatively impressive ESG rating, which will ultimately attract more investors. Subsequently, as investment increases, companies will pay more attention to ESG disclosure, creating a virtuous circle.

Keywords: ESG, disclosure, rating, investment, cycle, enterprise.

1. Introduction

This paper is based on the fact that ESG has gradually entered everyone's field of vision and has become the focus of attention in the field and academia. ESG breaks away from the past focus on financial performance by integrating ESG performance into a company's rating system. In addition ESG has gradually become a very important indicator in the minds of investors to measure enterprises. Therefore, this paper discusses the three aspects of ESG disclosure, rating and investment, and points out the cyclical phenomenon of the three parts.

This paper focuses on three stages of ESG, including ESG disclosure, rating and investment. To be specific, it discusses the current situation of ESG disclosure and rating in China and abroad, and the corresponding impact on the investment field. This paper adopts the method of systematic review, and collects ten relevant literatures. It compares and analyses the current international and Chinese development status in terms of disclosure and rating, and introduces the impact and recommendations of various parts of ESG, as well as their transmission mechanism. In addition, this paper also discusses the impact of ESG on investment, the impact on society and the overall economy.

The main body is divided into three parts, which are ESG disclosure, ESG rating and ESG investment respectively. The study of the respective areas of these three components of ESG and their interactions has positively contributed to the ESG operations of listed companies in international and Chinese markets, and ESG rating is a very important metric for investors. The paper concludes by proposing a circular relationship between ESG disclosure, ratings and investment, a circular mechanism that establishes the importance of ESG in the economy and society.

2. ESG Disclosure

2.1. ESG Disclosure Standards

As the ESG concept drawing more and more attention from the society, the information demand of stakeholders for the sustainable development of enterprises is constantly increasing. Therefore, ESG disclosure is proposed to make ESG information of listed companies transparent. In addition, there is an urgent need to promote active and positive disclosure of ESG information and to enhance the peer effect of ESG disclosure [1]. Through information disclosure, unnecessary or irreversible

harm to the environment and society can be effectively avoided when listed companies operate or carry out their work. Moreover, ESG information disclosure can enable investors to make more correct and accurate decisions. Listed companies should disclose ESG information according to the principles of authenticity, timeliness, comprehensiveness, and symmetry [2].

2.2. ESG Disclosure in Foreign Countries

In the international community, there are many reasons for the ESG information disclosure of listed companies, including the requirements of social protection of the environment and the specific responsibilities that enterprises should have. In addition, as the concept of ESG gradually becomes popular around the world, many large organizations and countries are beginning to disclose ESG information, such as the European Union's (EU) ESG information disclosure and the United States' (US) ESG information disclosure. In foreign countries, the methods of ESG information disclosure vary from country to country, industry to company. There are some of the common ways in which foreign ESG disclosures are made, including ESG report, sustainability report, the Global Reporting Initiative (GRI) standards and the United Nations Global Compact (UNGC). The ESG report is specially released by many companies to introduce the company's planning and goals in ESG. Also, some companies include ESG information in their sustainability reporting. The GRI standards refers to a set of universal sustainability reporting guidelines, furthermore, the UNGC is a set of ten principles that members of the UN Global Compact have committed themselves to, including broader ESG disclosures.

2.3. ESG Disclosure in China

In the current international environment that focuses on environmental protection and social responsibility management, ESG disclosure is needed throughout the world. Meanwhile, it is crucial for China to follow the international trend of ESG disclosure in the face of environmental and corporate social responsibility (CSR) issues. Although ESG development in China is still in its early stages, the ESG concept aligns well with China's philosophy of green and sustainable development [3]. The Chinese government attaches great importance to ESG information disclosure, and proposes that the concept of ESG is consistent with the concept of China's development path. It also proposes that ESG has a positive guidance and promotion of China's economic development. Furthermore, the disclosure of ESG information can encourage listed companies to implement sustainable development practices. This includes ecological and environmental considerations, social responsibility, and corporate governance. By doing so, companies can establish a positive image, attract investors and customers, and improve cooperation within the company.

2.4. The Impact of ESG Disclosure

The impact of ESG disclosure on enterprises and the entire economy is multi-dimensional and multi-faceted. For enterprises, for example, ESG disclosure improves corporate transparency and governance, helps reduce information asymmetry, and enhances the trust of investors and stakeholders in enterprises. Moreover, ESG disclosure promotes the sustainable development of enterprises. Enterprises are forced to consider the impact of their behavior on the environment and society, and passively develop more reasonable and effective governance methods, thus promoting the development of enterprises. What is more, when an enterprise makes ESG-related disclosure, it can also improve its reputation, enhance its brand value, and attract more investors and capital investment. The disclosure work shows consumers and investors how much an enterprise cares about social environmental protection and social responsibility. Finally, the disclosure of ESG can also promote the supervision of the government, and the government will introduce relevant policies to support the development of ESG and promote the code of conduct of listed enterprises. In general, ESG disclosure contributes to the development of the entire economy in a nation, and also plays a role in monitoring and supervising enterprises, promoting the sustainable development of a nation.

However, every economy in the world still faces many challenges in ESG information disclosure. For example, there is no unified ESG-related information disclosure standard in the world, resulting in uneven ESG information disclosure in various places, and the lack of comparable regulations for ESG information disclosure in different enterprises. This increases the difficulty for the implementation of the following two stages of ESG rating and ESG investment.

Therefore, in order to develop ESG concept and successfully carry out the following two stages of ESG rating and investment, it is necessary to do a good job in ESG information disclosure. First of all, a unified ESG information disclosure standard for all listed companies should be proposed by international organizations to clarify the core content and indicators. Second, the international community should improve the relevant policies of ESG information disclosure, change the current voluntary information disclosure provisions of various countries to semi-mandatory information disclosure provisions. Therefore, more enterprises can participate in the ranks of supervision and play a positive role in promoting the development and management of the entire economy. Finally, relevant departments need to strengthen the construction of ESG information disclosure supervision system, which is conducive to the stable and efficient implementation of ESG information disclosure.

3. For ESG rating and investment, ESG disclosure lays the foundation for the next two stages, so that the two stages of rating and investment can be carried out normally ESG Rating

3.1. ESG Rating Definition and Standard

ESG rating refers to the overall evaluation and grading of ESG information disclosed by a listed company by a third party, including commercial institutions and non-profit organizations. Nowadays, ESG rating has gradually become a new indicator to measure the performance of listed companies. The evaluation rating reflects the performance of the assessed object in ESG factors. It is primarily conducted by rating agencies and data providers and serves as a crucial reference for investment decisions [4]. However, it is important to note that a higher ESG rating does not mean that a company is at the forefront of society in terms of its sustainable contribution to society and the environment. ESG ratings are a true reflection of risk, reflecting industry-specific exposures and a company's ability to manage those risks.

3.2. ESG Mainstream Rating Standards in Foreign Countries

Now the mainstream ESG rating system in the international market is different from many others. This article lists three main rating systems. The first one is called Dow Jones Sustainability Index (DJSI), which is the world's first sustainability index launched by Dow Jones in 1999 and proposes questionnaires to collect and capture public information. And now DJSI is considered to be one of the global benchmarks for socially responsible investment. DJSI assesses and ranks companies according to their performance in the field of ESG, and releases a series of different indexes. Examples include DJSI World, DJSI Europe, DJSI North America, etc. These indexes are designed to help investors identify companies that are performing well in terms of sustainability for ESG investments.

The second one is that Morgan Stanley Capital International (MSCI) ESG Methodology. MSCI Index refers to a series of stock price indices provided by MSCI which is the most widely used reference index. It is based primarily on a company's financial data and ESG disclosure data to reflect society's ESG performance. The reliability of its data is very high, different industries are classified at different levels of detail, and different ESG standards are formulated for different industries to make its rating results more accurate and reliable.

Finally, the third rating system is Financial Times and Stock Exchange (FTSE) Russell ESG Rating. It is provided by the British financial market index provider, mainly based on the company's market data and public information. Its evaluation method mainly emphasizes ESG related to investment,

because these are related to long-term value creation, which is more in line with what investors want to see, so as to facilitate investors to invest.

3.3. ESG Mainstream Rating Standards in China

Naturally, there are also many ESG rating standards and institutions in China. Three major rating systems have been selected to illustrate in this paper. The relatively widely used system is called Syn Tao Green Finance ESG rating system. Syn Tao Green Finance is a leading financial information service provider in China. The ESG rating body proposed by the company includes three sections: environment, society and governance, which is an assessment of the performance of enterprises in terms of sustainable development. In addition, its ESG rating covers all listed companies in China and also includes listed companies in Hong Kong, which has a very wide coverage. Another competitive rating system is China Alliance of Social Value Investment (CASVI) ESG Rating System. CASVI is a pioneer in promoting sustainable development evaluation and application in China. The ESG evaluation model of CASVI is divided into the "screening model" and the "assessment model", which are screened and then rated. The third rating system is China Securities ESG rating system. The design of the rating system is pragmatic and evidence-based, using both qualitative and quantitative measures. It takes into account the characteristics of the domestic market and draws on foreign experience to meet the needs of the domestic market [4].

3.4. The Impact of ESG Investment on Society and Business

The impact of ESG ratings on entire economy is multifaceted, especially in the context of the current increasing global emphasis on sustainable development and social responsibility. First, it can enhance the image and reputation of a listed enterprise. A good ESG rating can reflect a company's good behavior norms and goals, thus attracting more investors, customers and partners. Second, it effectively promotes the sustainable development of listed enterprises. Because ESG rating requires enterprises to pay attention to ESG issues, enterprises will regulate their own behaviors according to the rating standards, it encourages enterprises to develop more sustainable business strategies and policies to a certain extent. Third, it can improve the investment attractiveness of listed companies, and more and more investors around the world are incorporating ESG factors into their investment decisions. By participating in ESG ratings, companies can enhance their attractiveness in the eyes of investors and attract more ESG investment and capital inflows. Fourth, it can enhance the international competitiveness of a listed enterprise. With the increasing attention of the global market to ESG, enterprises' participation in ESG rating can enhance their international competitiveness. ESG performance in line with international standards helps companies gain recognition in the international market and expand overseas business and cooperation opportunities. However, ESG ratings may also cause companies to pay too much attention to ratings, which may lead to incidents of information fraud or malicious competition between companies. Another important and noteworthy issue is the divergence in ESG ratings. The divergence result from the differences in the scope and measurement methods of ESG evaluation systems. Compiling ESG ratings and identifying data sources is a complex process. There is no single standard for data collection or reporting, resulting in rating providers using different underlying data sources and varying in their determination of factors to measure [5].

Therefore, to mitigate ESG rating disagreement, companies should enhance the quality of their ESG information disclosure, showcase comprehensive ESG practices, and establish effective communication channels both internally and externally [6]. Furthermore, if the international community wants to build a perfect ESG evaluation system, it should combine the national conditions, laws and regulations, social responsibility, and consider the market environment and enterprise conditions to create a unified and clear rating system.

4. ESG Investment

4.1. Investors' View on ESG Investment

ESG investment is an investment strategy that takes ESG responsibilities into consideration when making investment decisions in the financial market [7]. There are many types of ESG investment strategies, the most commonly used of which are screening strategies, which can be divided into positive screening and negative screening. Negative screening of ESG investments is when investors reduce portfolio risk and improve investment sustainability by excluding companies that do not meet a specified ESG criterion. Through negative screening, investors can avoid investing in companies with serious ESG risks and controversies. ESG's negative screening includes the exclusion of some specific industries, the exclusion of environmental risk companies, the exclusion of social risk companies, the exclusion of poor governance companies, the exclusion of non-compliance companies, and so on. This screening approach helps investors make more responsible and meaningful investments.

Another screening method for ESG investment is positive screening. Positive screening for ESG investment means that investors actively select companies or industries that align with their values and standards according to specific ESG criteria and guidelines to promote sustainability and social responsibility. Positive screening includes environmentally friendly companies, socially responsible companies, and socially influential companies. Through positive screening, investors can select investments that perform well in the ESG field and are aligned with their values and standards, promoting sustainability and social responsibility while achieving long-term sound investment returns. This screening approach helps investors support and invest in businesses that positively impact society and the environment and promote sustainability.

For investors, ESG rating can help investors more comprehensively understand the potential investment risks. Considering the ESG factors, investors can better understand the overall performance and risks of the company, so as to make more intelligent investment decisions. Moreover, many investors believe that ratings will help them identify companies with higher long-term value and greater potential, and guide them to invest in these capable companies. For investment funds, investors prefer ESG funds that adhere to a legally-based definition of sustainability rather than those that follow the EU Taxonomy [8]. Investors believe that considering ESG factors can help them reduce reputation and brand risk in their portfolios. Choosing companies with good ESG performance can help avoid investing in companies with negative impact and controversy, protecting the reputation and value of the portfolio.

4.2. The Impact of ESG Investment on Society and Business

First of all, the most important role of ESG investment is to promote enterprises to fulfill their social responsibilities and carry out sustainable development, promote the progress of enterprises, and improve the influence of enterprises. ESG investment draws investors with sustainable concern, which leads to a greater level of influence of the firm. The expansion of the influence of enterprises themselves has a positive impact on society. Therefore, companies with superior ESG performance are likely to invest more efficiently [9]. While ESG investing can bring many benefits, it is not without its drawbacks. It can lead to companies using fake ratings to attract investment, putting investors at risk. Thus, mainstream investors have expressed doubts about the ability of companies with high ESG scores to generate competitive returns for their shareholders [10]. Some companies may use "green whitewashing" to enhance their environmentally friendly image, such as falsely advertising their environmental measures, green projects, or carbon neutral programs in order to obtain a higher ESG rating, without actually taking substantial environmental actions. This behavior will lead to investors making irrational decisions.

All in all, ESG itself is a good development direction, but it needs social supervision, a complete legal system and a unified evaluation system to support its corresponding benefits.

5. Summary

This paper summarizes the work of ESG disclosure and rating in China and abroad, and puts forward the impact of investment work. It is quite obvious that the relationship between ESG disclosure, ratings and investment is circular. Enterprises participate in ESG rating by providing accurate and effective information through by ESG disclosure, so that enterprises can receive a rating, and investors can identify the capabilities of enterprises according to different ratings of different enterprises, so that investors can make appropriate investment decisions. In turn, companies will attract more investment and gain a better social reputation based on their ESG performance, which will also encourages greater involvement in CSR activities. They will be more willing to disclose relevant ESG information and receive higher ESG ratings, creating a virtuous circle.

In summary, ESG is a major development direction at present, and the three main parts are expected to form a virtuous circle. But because of the short development time, there are inconsistent standards, the regulatory system is not strict, information fraud or malicious competition problems. Therefore, it is necessary for the government and regulatory authorities to improve the corresponding system and create a more suitable environment for ESG development.

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