The Effect of ESG Performance On Firm Value

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Abstract. ESG is an acronym for Environmental, Social and Governance. Its goal is to evaluate the company's efforts to advance social and environmental benefits as well as the quality of corporate governance. Corporate ESG performance is highlighted in both Western and Chinese markets, which has a substantial impact on firm value. This paper selected NIO, a representative company of the Chinese new energy sources automobile industry as a research case to analyze the impacts of its ESG performance on firm value. ESG performance was proven to positively affect company share prices and to both reflect and affect a company's financial performance. Additionally, this report offered suggestions for improving NIO's ESG performance in terms of corporate governance and product quality. This research made a novel suggestion that the effect of ESG on business value depended not only on the firm's own ESG performance but also on the ESG performance of its rival companies.

Keywords: ESG performance; firm value; new energy automobile.

1. Introduction

ESG, or environmental, social, and governance, is an abbreviation. Its goal is to evaluate how a company's operations are sustainable and how they affect the environment, society, and corporate governance. The company's environmental management system, energy use, pollution, use of renewable energy, and adoption of the circular economy are the primary topics of the environmental indicators. Social indicators consider a company's safeguarding of employees' rights and interests in its operations, its management of the supply chain, its consumer protection policies, and its relationship with the community and other stakeholders. Governance indicators contain board setup, internal controls, and audit independence. In the past two decades, the ESG concept has been widely practiced and promoted among governments and market players around the world. It became one of the mainstream investment concepts and practice strategies in developed and emerging market countries.

The automotive industry is one of the largest global carbon emitters. By implementing the ESG, the long-term growth and survival of the company, environment, and society will both be affected. After experiencing rapid economic development over the past 30 years, our country has also left behind such problems as environmental degradation and social injustice. A growing emphasis on ESG has been backed by policy in recent years.

This paper used NIO as an example in this context to analyze how ESG performance affects the worth of a company. This study contributed to the corpus of knowledge on ESG performance and corporate value in China, a developing country with dubious ESG standards. It also provided implications for the popularisation of ESG practices globally. The case studies of ESG performance in the new energy automobile industry, however, were improved by this study. It revealed how ESG affected firm value and how ESG reflected corporate sustainability. It also provided references and suggestions for new energy automotive companies in terms of ESG. This article presented a novel idea that the effect of ESG on corporate success depends on both the company's own ESG performance and the ESG performance of its rivals.

2. Literature Review

In the existing research on ESG on firm value, most scholars agreed that ESG had a positive impact on firm value According to Bahadori Negar, Kaymak Turhan, and Seraj Mehdi [1], businesses with better ESG ratings were more profitable in the multi-industry sample of businesses after accounting for company size and leverage. According to Xin Jin and Xue Lei [2], compared to state-owned companies, ESG has a stronger impact on company value in China's non-state-owned businesses. This is especially true in eastern China, where ESG's value-enhancing effect is more prominent. A substantial positive link between ESG ratings and stock returns was discovered by La Torre et al. [3] in 2020, indicating that businesses that invested in ESG saw higher profits. Numerous. Scholars have similarly linked ESG to corporate risk. Engelhardt et al. [4] used European firms as the subject of the study and discovered a correlation between better ESG ratings for companies with higher stock returns and lower stock volatility. According to Maha Faisal Alsayegh, Rashidah Abdul Rahman, and Saeid Homayoun [5], the implementation of environmental and social activities within a successful corporate governance framework improved the firm's corporate sustainability performance. The authors Ruhaya Atan, Md Mahmudul Alam, Jamaliah Said, and Mohammed Zamri [6] found that the total ESG score had a beneficial and substantial effect on a company's cost of capital (WACC). Capelle-Blancard G. and Petit A. [7] found that the negative information revealed by firms could damage corporate value, but the positive information just had a little promotion on corporate value. Some academics, however, took a different stance. Sahut Jean-Michel and Pasquini-Descomps Hélène [8] found that during 2007-2011, the impact of news-based ESG performance scores varied from different countries: the impact in the UK is significant while that in the US is less significant. Dasgupta R. [9] found that firms with bad financial performance tend to reveal good messages that are not relevant to their financial performance. Ruan Lei and Liu Heng [10] used samples of Chinese companies with A-share listings in Shanghai and Shenzhen and ESG rating data collected from 2015 to 2019 to find that corporate ESG initiatives had a considerably detrimental impact on company performance. There is some debate in the literature currently available about how ESG performance affects corporate performance. This may be due to differences in sample selection such as country differences and industry differences. Therefore, it is necessary to study how ESG performance affects firm performance in specific industries or even a specific case.

3. ESG Practices in China

The disclosure and performance of ESG information by Chinese enterprises have become a global hot topic. China currently lacks formal legislation, regulations, or guideline documents for ESG information disclosure, with the exception of the "Environmental, Social, and Governance Guidelines" published by the Hong Kong Stock Exchange. The China Securities Regulatory Commission's amended and published "Guidelines on Corporate Governance of Listed Companies" only created the fundamental framework for ESG information disclosure. This has resulted in significant differences in the standardization of information disclosure among Chinese listed companies compared to foreign countries, making it impossible to directly copy foreign evaluation indicators. Currently, Chinese enterprises' disclosure of ESG information is voluntary, with mandatory disclosure limited to specific industries for some ESG information, and without a clear and systematic disclosure framework.

In terms of the number of companies reporting ESG-related reports, A-share listed companies have increased year by year. The overall disclosure rate has slowly but steadily risen, with the proportion of A-share listed companies that issue independent ESG-related reports increasing from 24.9% in 2018 to 26.9% in 2021.

4. NIO's ESG Performance

4.1. The Basic Information of NIO

NIO was founded on November 25, 2014, and is a domestic high-end electric vehicle brand based globally. The sales of NIO cars rank among the top five in China's luxury new energy vehicle market.

The New York Stock Exchange (NYSE) formally listed NIO with the stock code "NIO" on September 12, 2018. NIO did not publish an ESG report at the time of IPO since the American stock market did not yet require corporations to disclose ESG data. The successful listing of NIO on the Singapore Exchange took place on May 20, 2022. NIO was formally admitted to trading on the Hong Kong Stock Exchange's main board on March 10, 2022. At that time, the HKEX had a sound system for disclosing ESG information requirements, so NIO released its first ESG report on September 30, 2022, and received an A-rating from MSCI ESG rating.

4.2. Environment-related Performance

At the level of environmental protection, NIO actively introduced carbon reduction measures. It has established a sustainable development working group responsible for coordinating the integration of sustainable development work with various related business lines. NIO has been adhering to the concept of "low-carbon" from the design stage. In order to develop a full lifecycle carbon footprint management, it consistently empowers supply chain partners, insists on choosing innovative renewable low-carbon materials for design and manufacture, and combines green manufacturing, low-carbon logistics, low-carbon consumption, and low-carbon operations. NIO's ESG performance on the environment is better than the peer average. NIO has a score of 0.25 for Environment by Wind, while the average score for the automotive sector was 3.85.

4.3. Social-related Performance

NIO's actions in fulfilling social responsibility are primarily reflected in disaster relief funding and charitable public welfare. When the flood occurred in Henan province in July 2021, NIO mobilized resources from all over the country to donate 15 million RMB to support Henan. With the company, NIO has worked on a number of public welfare initiatives, including the "Qingxiu Project" for rural rejuvenation. In addition, NIO has also established a sound user-trust public welfare project. NIO paid high attention to vulnerable groups to realize social welfare, car owner care, and mutual growth. NIO has a score of 3.47 for Social by Wind, while the average score for the automotive sector was 4.91.

4.4. Governance-related Performance

NIO's board of directors, which oversees corporate governance, is made up of six people, including one woman and three independent directors. NIO established a highly effective risk management and internal control system and conducted numerous risk audits. NIO set up an ESG Committee and developed related systems. NIO actively communicated with stakeholders through a combination of online and offline means. NIO also established a business ethics management system and an integrity reporting mechanism. NIO has a score of 6.20 for Governance by Wind, while the average score for the automotive sector was 6.54.

5. Corporate ESG Performance's Effect on Firm Value

5.1. The Impact on Corporate Financial Performance

Table 1. NIO and LI's finance indicators.

	NIO	LI
ROE	-34.17%	-0.91%
ROA	-15.38%	-0.65%
TAT	52.55%	55%

ROE in Table 1 means the Rate of Return on Common Stockholders' Equity. ROA in Table 1 means Return on Assets. TAT in Table 1 means Total Assets Turnover.

This paper have analyzed NIO and Leading Idea (LI)'s financial performance in 2021. Leading Idea is a new energy vehicle company, a competitor of NIO. As shown in Table 1, in 2021 both NIO's ROE and ROA were negative and much lower than those of the LI. In 2021, LI's ESG rating was AA, while NIO's rating was only A. In the new energy sector, consumers are more concerned about the sustainable development of companies and their awareness of environmental and social responsibility. They may choose companies with better ESG performance. This caused NIO's sales to be lower than LI's. NIO has a poor ESG rating for CORPORATE GOVERNANCE. It leads to NIO's Total Asset Turnover being lower than LI. So the financial performance was really affected by ESG performance to some extent.

5.2. Impact of ESG Performance on Market Performance

NIO's ESG rating was A, lower than that of its competitor LiXiang. This paper used event analysis to evaluate NIO's market performance in 2022 after it disclosed its ESG performance. The estimation period was 136 days, for the reason that there were only 136 days between NIO's listing date on the Hong Kong stock market and the release date of its ESG report. The event window was 3 days. The event date was September 30, when NIO released its ESG reports. The stock return data adapted in this paper is sourced from the Eastmoney Choice database.

Table 2. The CAR values for NIO.

CAR	-1.7352

This paper calculated the abnormal rates of return on the day before the event, the event day, and the day after the event respectively, and the CAR is the sum of them.

Table 3. The CAR values for LI.

CAR	4.1730

Table 2 shows that the sum of abnormal returns (CAR) for the event window of NIO is -1.735, a negative value, suggesting that the disclosure of the ESG report had a negative impact on the corporate future stock returns.

Even though Ideal's annual report was released on the same day as the ESG report, Ideal's annual report for that year showed that the company's return on net assets for the year was -0.91% and its return on total assets was -0.65%. There's no doubt that these data would have had a negative impact on the stock price, but Table 3 shows that the sum of abnormal returns (CAR) for the event window of LI is 4.1730, a positive value, which means under the circumstance of the company’s annual report may cool down the stock price, the company's future stock returns were positively impacted by the ESG report's disclosure.

This paper find that a company's stock returns can be adversely affected by an ESG rating that is relatively low in comparison to its rivals.

6. Discussions of NIO's ESG Performance

NIO's CORPORATE GOVERNANCE aspects of the score are lower. It has high corporate debt and poor capital structure. It is recommended that NIO should improve its ability to integrate the upstream supply chain and ensure the supply of raw materials to stabilize trading volume. It can be observed that in 2022 Azure has already carried out an operation to develop its own batteries. Although in the short term, it consumes a lot of money, it is essential for the long-term development of the company.

NIO's score on PRODUCT SAFETY & QUALITY is lower. NIO's production capacity and qualification layout is relatively lagging behind compared to other leading enterprises. NIO chose

Jianghuai Automobile Corporation (JAC) as its OEM, and JAC's capacity to regulate quality is not outstanding in the market. Therefore, it is recommended that NIO take a stake in JAC to achieve control or choose a better OEM.

7. Conclusion

Summarising the above studies, this paper came to the conclusion that certain components of firm performance will be impacted by ESG performance. In terms of market performance, ESG performance will favor businesses with high ESG ratings when compared to rivals. And it had a negative impact on companies with low ESG ratings compared to competitors. In terms of financial performance, with the increasing attention paid to ESG, corporate ESG performance would also affect the company's financial performance.

Though this paper has made every effort to minimize the impact of releasing the annual report on the same day as the ESG report, it will still inevitably have an impact on the findings, more or less. By the way, this paper just presented the exact phenomenon that corporate ESG performance moved in the same direction as financial performance.

For future research, it may be better to start by increasing the sample size and using the comparative analysis method as the main method to study the whole industry.

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