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Research on ESG performance in Chinese listed firms: Perspective of economic policy uncertainty

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Abstract: In the context of the rapid transformation of the global economy, the impact of economic policy uncertainty (EPU) has penetrated into all areas of production and life. As an important indicator system for measuring non-financial performance of firms, ESG has emerged in recent years. From the perspective of economic policy uncertainty, it is significant to understand the development and changes of ESG in Chinese listed firms correctly for realizing high-quality development. Using qualitative research method and combining with practical research experience, this paper discusses the impact of EPU on Chinese listed firms' ESG performance through ownership. Specifically, we develop analysis from there aspects, including Relationship between social and economic benefits, Employee Benefits and Corporate Governance and ESG Reaction Mechanism in the Context of Uncertainty. We find that under the impact of uncertainty, it is necessary to deeply understand the actual performance of ESG in enterprises with different ownership and the internal motivation of ESG investment, which could be play a vital role in achieving China's "dual carbon" strategic goals and effectively promote sustainable and high-quality development.

Keywords: ESG performance; Economic policy uncertainty; Chinese listed firms.

1. Introduction

Both the new institutional economics represented by North and the new growth theory represented by Romer and Lucas emphasize the importance of institutional environment for the behavior of micro entities and economic growth. The political environment is a very important component of the institutional environment, which not only has a profound impact on macroeconomic development, but also plays a crucial role in enterprise decision-making. In recent years, against the backdrop of slowing global economic growth, the spread of the epidemic, and the increasingly complex international situation, economic policy uncertainty (EPU, hereafter) has attracted high attention from the academic community (Białkowski et al., n.d.; Bloom et al., 2018; Vural-Yavaş, 2020).

Relevant research has found that EPU not only affects macroeconomic factors such as foreign direct investment, bond issuance and exchange rate, but also affects micro enterprise behavior such as investment and mergers and acquisitions, stock prices, company value, and IPO decision-making(Çolak et al., 2017; Julio and Yook, 2012). And corporate investment behavior under uncertainty is a long-standing issue among many corporate behaviors among them. Figure 1 shows that the index of economic policy uncertainty fluctuates sharply and continues to rise in recent years(Baker et al., 2016).

At the same time, due to the continuous prominence of environmental pollution, corporate social responsibility, and other issues in recent years, in order to make up for the limitations of traditional financial indicators, environmental, social, and corporate governance (ESG) systems have emerged as the era requires. ESG information includes non-financial indicators such as environmental, social, and corporate governance, reflecting the sustainable development ability of enterprises, which can reduce information asymmetry to a certain extent, help investors understand the enterprise more comprehensively and avoid risks(Brogi and Lagasio, 2019; Peiris and Evans, n.d.).

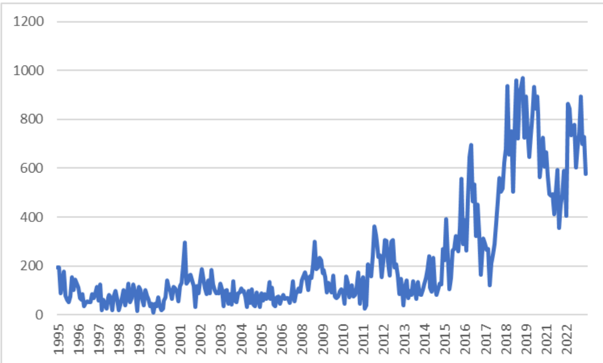

Figure 1. Monthly Chinese Economic Policy Uncertainty Index

In China, the development of ESG is mainly related to the following factors: First, there are policy guidance and regulatory implementation in China. Macroscopic factors such as national policies have always been an important booster for the development of China's ESG: the proposal of new development concepts and "dual carbon goals" has further promoted the development of enterprises towards environmentally friendly development; In 2018, the CSRC stipulated that listed companies have the responsibility to disclose ESG information; In 2021, key pollutant discharge listed companies are required to disclose specific pollutant discharge information, and all listed companies are required to disclose the administrative penalties received due to environmental issues. Secondly, it is important to meet the demands of comprehensive evaluation of enterprises. In recent years, major illegal events such as long-term financial fraud in Chinese listed firms have been common, bringing great risks and even actual losses to investors. As a result, external information users hope to remove various aspects of information other than financial information, in order to increase the information transparency and external supervision of enterprises, pay more attention to the long-term value and sustainable development ability of the enterprise and avoid "mine explosion" events caused by issues such as imperfect corporate governance. Third, Chinese listed firms tend to comply with the trend of opening up of the capital market. As the gradual deepening of the opening up of the capital market to the outside world, the international community has also put forward higher requirements for ESG information disclosure of Chinese A-shares considering the factors such as information comparability. Therefore, ESG information disclosure can also help to introduce international capital.

These factors have prompted more firms to actively understand ESG, and the number of firms disclosing ESG information is also increasing year by year. However, compared to developed countries, China's ESG development started relatively late. As the Figure 2 indicates, according to the data from Wind, the proportion of A-share listed companies that released ESG reports in 2020 was just nearly a quarter, and there is still much room for improvement in the motivation of enterprises to independently disclose ESG information.

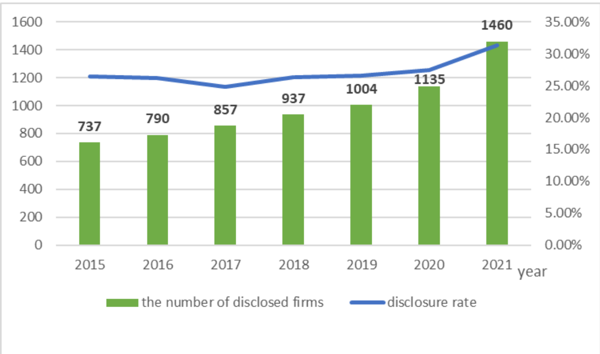

Figure 2. Trend in the number and rate of firms disclosing ESG reports

As a result, academic research in this field has become increasingly prosperous with the increasing attention paid by ESG. Most of the existing research focuses on the influencing factors of ESG information disclosure from the perspectives of corporate governance structure characteristics, equity structure, company size and financial situation(Ilyas et al., 2022; Vural-Yavaş, 2020; Wang et al., 2023), while less attention is paid to the impact of macroeconomic institutional factors such as economic policy uncertainty on ESG information disclosure. From the perspective of investment and financing, most studies believe that there are ESG risk premiums and additional returns in the market and investors have certain ESG preferences(Gulen and Ion, 2016). Enterprise disclosure of ESG can reduce information asymmetry and improve investment efficiency. However, when EPU is high, companies tend to hold more cash flow, improve earnings management, and so on. On this basis, especially in the context of global warming, sustained growth in carbon emissions, and environmental degradation, the study of EPU and corporate ESG performance deserves further exploration, while the current literature on related issues is extremely limited. Therefore, this article attempts to explore the driving factors for companies to disclose ESG information from such a new perspective, thereby promoting the efficient implementation of policies.

2. Methods

Firstly, this paper adopts the literature research method to search the related literature on ESG performance and economic policy uncertainty around the world through Elsevier and CNKI. Besides, we tend to find the essence of each phenomenon by using qualitative research. One of the qualitative research strategies developed is a case study. Case studies are very useful to realize a phenomenon comprehensively and to foresee its development in the future.

Then we explore the mechanism of firms' ESG reaction to uncertainty and discuss heterogeneity from the perspective of ownership by qualitative analysis. Finally, combining theory with practice, this paper puts some suggestions and draws the conclusion for the implement of ESG during uncertainty.

3. Findings and Discussion

From the inside perspective, ESG performance expenditures are similar to "insurance premiums" paid in advance, which can play an "insurance" role on performance in the face of specific events during the period of high uncertainty. ESG performance can also be seen as a potential risk management tool that can create value for shareholders in the face of certain types of negative events. From the perspective of external market, stakeholders can perceive and evaluate the potential motivation of a company to participate in ESG practices. If the motivation for participation is considered to be not entirely selfish, the company will enhance moral capital due to social responsibility activities, which can serve as a buffer against risks during periods of negative impact on the company(Godfrey et al., 2009). Therefore, in the face of the negative impact of economic policy uncertainty on financing constraints, improving ESG performance can be seen as an "insurance" for early payment, which can increase the investment confidence of shareholders, creditors, etc., and alleviate the degree of financing constraints through improved corporate reputation and moral capital during a downturn in the macro environment.

One the one hand, based on stakeholder theory and signal theory, when uncertainty is high, enterprises need to improve ESG performance to release positive signals to multiple stakeholders to mitigate operational risks, mitigating the uncertainty risks of enterprises under increased policy uncertainty(Freeman, 1999). On the other hand, corporate ESG activities is a social behavior that conforms to the government's public value creation goals. By fulfilling social responsibility, enterprises can correspondingly attract the attention of the government to enterprises. Unlike developed countries in general, ESG practice is an effective tool for market competition and a strategic political contribution in transition countries. When the government cannot provide sufficient funds for public services, it will seek additional funds from enterprises. Therefore, ESG has played a certain role in rent seeking in China's transformation process, which means that ESG, as a relatively safe and more effective tool for enterprises to seek rent from the government, also conforms to the tool value under the strategic perspective.

However, in Chinese context, state-owned enterprises (SOEs) have significantly different characteristics compared to ordinary enterprises(Yuan et al., 2022). Existing research shows that compared to non-SOEs, SOEs have stronger information advantages, lower financing constraints, and a lower degree of investment reduction when faced with uncertainty(Zhang et al., 2015). In fact, based on our case studies and field research experience, when faced with highly uncertain policy uncertainties, there are many differences in ESG performance and underlying mechanisms between SOEs and non-SOEs.

3.1. Relationship between social and economic benefits

The fundamental purpose of economic and social development is to serve the people, with the goal of improving people's wellbeing, not the sole goal of maximizing one's own interests. In particular, SOEs, practicing the ESG concept, not only pursue corporate profits, but also assume social responsibility for the realization of public interests from the perspective of the interests of the people and the country. This has become the development trend of ESG in China.

A large number of traditional studies have shown that the economic benefits of SOEs are far inferior to those of large private enterprises. However, actual research shows that SOEs place social benefits first in their annual assessment standards and annual work arrangements. Every year, a portion of the economic benefits will be invested in society, allowing the broad masses of people to share this economic benefit. In the investigation, the leader cited an example. During the two-month project, their enterprises will also conscientiously comply with relevant national regulations and fulfill their due responsibilities in dust removal, noise removal, environmental protection(Fang et al., 2023), etc.

However, in order to pursue economic benefits, private enterprises may reduce or even not take corresponding engineering measures. The leaders also stated that the annual performance of their social benefits will be monitored and evaluated by relevant government departments, and if they fail to meet the standards, the group's management will be affected to some extent. From this perspective, we can see that ESG has a relatively obvious application in SOEs, which can achieve environmental protection and investment in social benefits. Among SOEs, social benefits come first and economic benefits come second. However, ESG activities are a more kind of instrument out of reason among non-SOEs.

3.2. Employee Benefits and Corporate Governance

Through the case study, we visited SOEs' employee restaurants, office spaces, entertainment, sports facilities and company environment in actual research. It is not difficult to find that among SOEs the welfare and facilities are quite complete. SOEs focus on allowing their employees to enjoy the fruits of their company's development and better integrate their employees into their groups. Actual research shows that in recent years, employees recruited on campus have been able to stay and there will be no large-scale turnover. At the same time, during the epidemic period, the company can provide corresponding care and psychological counseling to employees to ensure their labor income. In non-SOEs, under the macroeconomic impact of uncertainty, there have been widespread layoffs and employee turnover. Non-SOEs are more focused on profit as their primary goal, which inevitably leads to a lack of employee welfare.

At the same time, there will also be competitive relationships within the certain firm itself, and there will be potential factors to promote the corresponding departments to continuously carry out self-innovation, self-optimization, continuous progress and continuous improvement.

From the perspective of the entire company, its headquarters conducts annual audits of its subsidiaries, some of which are conducted by the group's audit department in a comprehensive manner, while the rest are conducted in cooperation with third-party accounting firms. It can be seen that the audit process is essential in SOEs, and the audit process is very strict, with a high degree of audit assurance.

Overall, the internal governance level of state-owned enterprises is relatively high, the internal management system is clearly divided, and the internal management efficiency is good. Non-SOEs are more likely to hire a third unit for audit work, and generally do not have special institutions to investigate internal corruption and inefficiency.

3.3. ESG Reaction Mechanism in the Context of Uncertainty

China's SOEs are more accepting government leadership and need to achieve many government goals, such as undertaking corporate social responsibility, solving employment problems and providing public services. Correspondingly, SOEs are also subject to internal supervision by the government and the Party committee, and have achieved good ESG performance while fulfilling corresponding internal assessment objectives. Under the impact of uncertainty, non-SOEs are facing stronger financing constraints and higher information costs(Le and Zak, 2006). Therefore, they need to release good signals and obtain stakeholder recognition through more comprehensive information disclosure. Therefore, non- SOEs have stronger motivation to improve ESG performance when facing high uncertainty.

However, many enterprises' ESG reports are more like self-praise or a tool for winning positive external evaluations, and they do not fully understand the spiritual connotation of ESG. For example, many enterprises display public welfare donations and other social benefits, but in fact, we believe that the so-called social benefits should also include the contribution of the enterprise itself to social stability and prosperity and development, such as reducing rentals for tenants during the epidemic, ensuring full salaries and benefits for enterprise employees, the spillover effect of public cultural space construction, and the positive externalities brought about by enriching cultural supply.

4. Conclusion

In recent years, ESG has gradually become an important indicator to measure the sustainable development and long-term investment value of listed companies. The proposal of the "dual carbon strategy" has further raised the requirements for ESG information disclosure by domestic enterprises. However, the development of ESG in China started relatively late compared with developed countries. Although the number of firms that disclose ESG information by A-share listed firms has increased year by year, the total number of companies that disclose ESG information is still not high, and there is a certain gap between the disclosure level and developed countries. To promote the development of ESG information disclosure in China, understanding its influencing factors and finding the internal motivation of enterprise disclosure become the key to solving the problem.

At the same time, special attention should be paid to the institutional differences between SOEs and non-SOEs, fully recognizing that corporate social responsibility and ESG performance have different meanings for enterprises with different ownership types. The impact of current economic policy uncertainty has permeated all areas of production and life. With the increasing pressure of global environmental degradation on society, sustainable and high-quality development has become a major issue in economic production. The Chinese government has incorporated the development of a green economy and the improvement of social equality into its "14th Five Year Plan", and has actively responded to the Paris Agreement by making a solemn commitment to achieve carbon peak by 2030 and carbon neutrality by 2060. ESG is an important indicator of high-quality development of enterprises. A correct understanding of the relationship between EPU and ESG can help the government formulate reasonable economic policies, prepare advance plans for potential uncertainties, deepen understanding of corporate behavior, improve the ESG indicator system, promote the development of ESG in China and the efficient implementation of policies related to improving social equality and developing a green economy.

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