

# How Does ESG Performance Affect Corporate Financial Performance?

## -- Analysis from Research Dynamics at Home and Abroad

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### Abstract

**This paper synthesizes the research trends both domestically and internationally on the impact of corporate Environmental, Social, and Governance (ESG) performance on its financial performance. The majority of the studies support a positive correlation between ESG and financial performance, suggesting that ESG practices contribute to sustainable development and enhance corporate financial outcomes. However, the relationship is complex and may be influenced by a variety of factors, including the measurement methods of indicators, the country or region of the research subjects, and the type of industry, leading to divergent conclusions in existing studies. By reviewing the relationship between ESG performance and financial performance, this paper organizes the differences in research subjects and results behind various conclusions, aiming to provide potential research paths for future studies.**

### Keywords

**ESG Performance; Corporate Financial Performance; Sustainable Development.**

## 1. Introduction

Facing the growing environmental challenges, the global focus has shifted towards how to promote sustainable economic and social development. Guided by social values and driven by the core concept of sustainable development, the ESG (Environmental, Social, and Governance) concept has gradually taken shape, entering the public eye based on the theoretical foundations of sustainable development, economic externalities, and corporate social responsibility. In 2004, the United Nations Global Compact released a research report titled "Who Cares Wins," which officially introduced the "ESG" concept to the public for the first time. This concept advocates that enterprises should not solely pursue the maximization of short-term profits but should fully integrate considerations of the environment, social responsibility, and corporate governance to achieve the goal of long-term sustainable development, committed to building a more harmonious and green business world.

With the profound changes in the business environment, more and more enterprises have come to deeply recognize the long-term impact of ESG factors on their development trajectory and investment value. Some enterprises have taken the lead in valuing and improving their performance in the three dimensions of environmental sustainability, social responsibility, and corporate governance, elevating corporate social responsibility to a strategic level and integrating it into daily business management processes. At the same time, the ESG investment philosophy has also developed rapidly worldwide, with an expanding market size and increasingly refined policies. The former China Banking and Insurance Regulatory Commission also clearly pointed out in relevant guidelines that banking and insurance institutions need to integrate the three elements of environment, society, and governance into business processes and risk management systems to continuously optimize relevant policies and processes. The

State-owned Assets Supervision and Administration Commission of the State Council also clearly required in the "Work Plan for Improving the Quality of Central Enterprises' Listed Companies" that central enterprise groups should comprehensively promote the construction of ESG systems for listed companies to ensure that they fully, accurately, and comprehensively implement new development concepts.

Existing academic literature has conducted in-depth and fruitful discussions on how ESG performance affects corporate operations, financial market operations, and risk management areas. In an ideal state, ESG investment should be a continuous investment from the perspective of long-term corporate development. Excellent ESG performance can not only optimize corporate investment efficiency but also to some extent reduce the risk of sudden stock price collapses and alleviate the burden of corporate financing costs. However, empirical studies on the relationship between ESG performance and corporate financial performance (CFP) have yielded divergent conclusions, with the promotion, inhibition, and irrelevance views coexisting. Although the "promotion view" is dominant, other different research findings should not be overlooked, as they also have value for in-depth exploration. In addition, many domestic and foreign scholars have conducted in-depth and extensive discussions on the regulatory mechanisms between the two. These diverse research conclusions and in-depth analysis of regulatory mechanisms together provide important theoretical contributions to revealing the complex influence relationship between ESG performance and financial performance.

## 2. Positive Perspective

In the multitude of academic studies exploring the positive correlation between ESG performance and corporate financial performance, scholars have generally identified two primary reasons. Firstly, it is observed that by disclosing their ESG practices, companies can significantly reduce the information asymmetry between stakeholders—such as creditors and shareholders—and the company itself. This effectively alleviates the financing constraints faced by the company, enhances the accessibility of funds in bond and equity financing for listed companies, and thereby promotes a steady improvement in financial performance (Yang, 2023; Yan, 2023). The second perspective emphasizes that a company's strong ESG performance can provide robust support for technological innovation across multiple dimensions, including information, talent, technology, and policy. This enhances the company's innovation efficiency, attracts more proprietary resources, expands market share, builds core competitiveness, and contributes to further strengthening of the company's financial performance (Peng, 2023; Cai, 2023).

### 2.1. Overall Dimension

In international research, Zhao (2018) and Baran (2022), with the latter focusing on Poland's energy sector, have both concluded that a company's strong ESG performance significantly enhances its financial performance. Building on this, Naeem (2022) discovered a significant positive correlation between the overall ESG performance of environmentally sensitive businesses and their equity return rates and Tobin's Q. This study also revealed that this positive correlation is more pronounced in developed countries. Extending this, DasGupta (2023) found that in common law countries, companies adopting more ESG practices improve their financial performance, while strong investor protection rights have a negative moderating effect. Concurrently, Fu (2023) demonstrated that digital transformation positively facilitates the role of ESG in enhancing financial performance. In heterogeneity tests, this effect is particularly significant in non-state-owned enterprises and those in the eastern regions, and the financial performance improvement for polluting enterprises is more pronounced than for non-polluting ones.

Furthermore, Wu (2024) explored the moderating effect of boardroom diversity on the relationship between ESG and financial performance, finding that it somewhat suppresses this interaction. Particularly when analyzing the sub-dimensions of boardroom diversity, the roles of overseas experience, age, and education are crucial. Lastly, Candio (2024), through an analysis of panel data from all companies listed in the EURO STOXX 600, concluded that the presence of CSR committees only negatively affects the impact of ESG scores on ROA, while external auditors of CSR reports may negatively affect stock prices.

In early Chinese research on corporate social responsibility (CSR), Li Ling (2015), Wu Fang (2015), Shao Cuili (2016), and Wei Liling (2016), each from the tourism, pharmaceutical, papermaking, and food industries, respectively, investigated the impact of CSR on corporate financial performance. These studies unanimously found a significant promotional effect. Liu Yanhua (2020) further indicated that an increase in foreign shareholding also positively affects corporate financial performance, with this effect being more pronounced under the influence of CSR. Meanwhile, Qi Dianwei (2020) found that corporate culture strengthens the impact of CSR on financial performance, especially in underdeveloped regions.

On this foundation, Chen Lingfang (2022) discovered that a company's ESG performance significantly enhances its overall performance, but this effect is constrained in enterprises facing financing constraints, particularly in non-state-owned and heavily polluting industries. Luo Jinghua (2022) concluded that the performance of ESG and its sub-dimensions is not only positively correlated with current corporate financial performance but also promotes lagged financial performance. However, the institutional environment has a negative moderating effect on the relationship between ESG performance and short-term financial performance, explained as institutions restricting companies from profiting from ESG actions in the short term. Furthermore, Sheng Yanmei (2024), in her study of ESG practices in the pharmaceutical manufacturing industry, showed that improving ESG performance has a positive effect on corporate financial performance, and government subsidy policies positively regulate this process.

## 2.2. Sub-Dimension

In addition to the overall investigation of the impact of ESG on financial performance, some scholars have further explored the three sub-dimensions of environmental, social, and governance, finding that their influence on corporate financial performance is manifested only or particularly in one or several specific sub-dimensions.

Cho (2019), through empirical research on South Korean listed companies, revealed that the positive association between corporate social responsibility performance and corporate financial performance is primarily attributed to the contributions of the social dimension. Subsequently, Liu (2022), using Chinese listed new energy companies as a sample, further explored the impact of different configurations of ESG on financial performance, discovering that the social pillar is the key driver of high financial performance, and this configuration remains stable over time. Abdi (2022), in his study of the aviation industry, found that improvements in the governance dimension can significantly enhance a company's price-to-book ratio, with company size playing a moderating role in this relationship, while the impact of the company's duration is not evident.

In similar research, Saygili (2022) also pointed out that the governance dimension related to shareholder rights and the board of directors has a positive impact on financial performance. The results of Liu (2022)'s study more finely reveal the different impacts of each ESG dimension on financial performance: the environmental dimension (E) shows a significant negative impact, the governance dimension (G) has a significant positive impact, while the impact of the social dimension (S) is not evident. Yang (2023), in his research on South Korean non-financial manufacturing and service companies, found that the environmental (E) and governance (G)

dimensions have a promoting effect on corporate profitability, while the impact of the social (S) dimension remains insignificant.

### 3. Negative Perspective

Despite the presence of dissenting opinions, there remains a body of scholarly work that posits a suppressive view on the relationship between ESG performance and corporate financial performance.

#### 3.1. Overall Dimension

In the research on the overall impact of ESG on financial performance, Mohamad (2019) discovered a significant negative correlation between the two when examining Malaysian listed companies. Further, Duque-Grisales et al. (2021), in their analysis of multinational corporations in Latin American emerging markets, also found a statistically significant negative correlation between ESG ratings and financial performance. Recently, Almulhim (2023) not only supported this perspective but also revealed the significant role of CEO personal characteristics in moderating the relationship between ESG and financial performance: the level of a CEO's workload and gender can mitigate potential negative effects, while educational background and tenure may exacerbate such negative links.

#### 3.2. Overall Dimension

In terms of sub-dimension research, Su (2019) noted that the environmental dimension has a negative impact on financial performance in the tertiary and resource-intensive manufacturing industries, a phenomenon not observed in secondary industry enterprises. Bătae (2021), from a banking sector perspective, found that improvements in the quality of corporate governance systems have had an adverse effect on financial performance, possibly due to market investors' lack of attention to banks' social responsibility actions and best governance practices. Additionally, Saygili (2022) demonstrated that in emerging markets, environmental disclosure also negatively affects financial performance.

### 4. Neutral Perspective

Beyond the perspectives of "promotion" and "suppression," global scholars have also introduced the viewpoint of "irrelevance," suggesting that the quality of ESG performance does not significantly impact corporate financial performance.

In this domain, the empirical study by Landi (2018) on Italian listed companies is noteworthy. He observed that over the past decade, there has been a continuous increase in corporate management's attention to social responsibility and sustainability, along with an improvement in the quality of the ESG evaluation system. Despite the widespread adoption of the ESG framework by investors for stock screening, the impact of companies' social responsibility and related investment activities on market premiums is not significant. Furthermore, Kuzey (2021) conducted research using performance measurement indicators across market, accounting, and sales dimensions and found that, unlike financial sector companies, those in the tourism and healthcare industries did not achieve a significant enhancement in financial performance from their social responsibility actions. It is worth noting that the establishment of CSR committees in the tourism industry can bring value to CSR performance and its changes, a phenomenon not observed in the healthcare and financial sectors. Arian (2023), in an in-depth study of industrial enterprises, found that, in contrast to studies in the consumer sector, there is no significant correlation between the performance of industrial enterprises in ESG and economic returns. This implies that the connection between corporate social responsibility performance and economic benefits in the industrial market still needs to be explored and

strengthened. Lastly, Chen (2023) discovered in his research on how ESG drives corporate financial performance that the positive correlation between ESG performance and corporate performance is significant only in large enterprises and is not evident in the sample of small enterprises.

## 5. Other Perspectives.

In academic research, some scholars have abandoned the traditional linear regression analysis and have instead adopted non-linear regression models to uncover the "U-shaped" or "inverted U-shaped" relationship between corporate ESG performance and financial performance.

Nollet (2016) was the first to propose that a significant U-shaped association between ESG and CFP is observed only within the governance domain. Wang Shuangjin (2020) further elucidated this "U-shaped" relationship, indicating that excessive initial investment in ESG strategies may lead to increased costs, thereby temporarily suppressing financial performance. However, as ESG responsibility performance soars, its value-added and innovation compensation effects gradually become prominent, ultimately transforming into a driving factor for financial performance. Thus, this relationship evolves paradoxically and dynamically from initial competition to later mutual promotion, overall presenting a non-linear "U-shaped" structure.

Conversely, Shan Mengmeng (2019) found an inverted U-shaped relationship between corporate social responsibility and financial performance, where financial performance increases with increased social responsibility investment within a certain range, but decreases beyond that range. This relationship is more pronounced in regions with higher marketization and in state-owned enterprises. Chen (2022) also demonstrated an inverted U-shaped relationship between ESG performance and financial performance in manufacturing enterprises, especially when excessive investment in environmental performance due to attention to climate change issues diminishes or even reverses its positive impact on financial performance.

Ma (2023) further confirmed this inverted U-shaped relationship, noting that as the level of corporate social responsibility moves from moderate to advanced, its correlation with financial performance shifts from positive to negative. This relationship also shows differences based on the CEO's political background and the nature of the enterprise. The studies by Bahadır (2024) and Lopatta (2024) similarly support this viewpoint.

## 6. Conclusion and Recommendations

### 6.1. Conclusion

In the field of research on the relationship between ESG and its sub-dimensions and corporate financial performance, despite the rich outcomes achieved, the significant divergence among different viewpoints still indicates that this area requires further exploration. These divergences may stem in part from the inconsistency in the measurement standards of ESG performance and financial performance, as well as the diversity of countries, regions, and industries where the research subjects are located, which affects the results. Therefore, it is particularly important to delve deeper into the discussion and analysis of these factors.

Moreover, the suppressive or promotive roles of internal and external influencing factors in this process urgently require further research. It is necessary to carefully examine whether the analysis results reflect the actual strategic choices of the company, or whether they are phenomena caused by the differences in the level and speed of regulatory and institutional development among various ESG industries. Studying the regulatory mechanisms will not only help expand the connotation of the relationship between ESG performance and corporate

financial performance but also provide a deep-level explanation for the emergence of differences in their relationship.

## 6.2. Recommendations for Future Research

There are still many deficiencies in the existing research exploring the association between ESG and corporate financial performance, which are in urgent need of in-depth and improvement.

Firstly, existing literature overly relies on single financial indicators, such as Return on Assets (ROA) and Return on Equity (ROE), when measuring ESG and corporate financial performance, which may omit other key factors. In light of this, future research should strive to build a more comprehensive and multidimensional evaluation system to accurately capture the complex connections between the two.

Secondly, research on one-dimensional ESG indicators urgently needs to be strengthened, as the detailed performance of ESG and related issues have significant implications for the enhancement of corporate sustainable development concepts. Companies strategically choose social responsibilities that match their characteristics and scale when fulfilling social responsibilities, which not only protects their own interests but also contributes to society. This will become an important direction for research on one-dimensional ESG indicators.

Furthermore, although research on the relationship between ESG and financial performance has made certain progress, case studies are still insufficient. The importance of strengthening case studies in this field cannot be overlooked, as they help reveal the differences in the relationship between ESG practices and financial performance across different industries and types of enterprises. For example, in the financial industry, the performance of ESG investment has a significant impact on institutional reputation and customer trust. Therefore, diverse case studies will deepen the understanding of the manifestation of the relationship between ESG and financial performance in different industries and types of enterprises.

Lastly, existing research mostly focuses on a single country or region, and cross-country comparative studies are relatively lacking. Future research should replicate and review existing frameworks in different data environments, legislation, and accounting contexts to strengthen the evidence base and deeply analyze the intrinsic mechanisms of the studied relationships. Conducting cross-country case comparison analyses or empirical studies will help reveal the commonalities and differences in the relationship between ESG and financial performance under different institutional backgrounds.

In summary, future research should focus on the aforementioned deficiencies, continuously optimize research methods, expand research horizons, to comprehensively and deeply elucidate the relationship between ESG and corporate financial performance and its underlying mechanisms. This will provide solid theoretical support for enterprises to practice ESG and promote corporate sustainable development.

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