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G R A D U A T I O N P R O J E C T

The Impact of ESG Factors on Financial Performance:

A Comprehensive Analysis of Companies in the UAE.

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Abstract

This study examines the relationship of environmental, social, and governance (ESG) factors to the financial performance of companies in the UAE from 2019 to 2023. For this study, we have selected the top 9 companies in the UAE from varying industries listed on the Abu Dhabi Securities Exchange for the past 5 years. The companies are selected based on sufficient data availability. The data is collected from their official websites and the data stream. The study uses Jamovi to analyze the impact of ESG factors on financial performance. The findings showed mixed results. The Environmental score showed a positive effect on profit margin but negative influence on ROA. Suggesting that Environmental score on one hand improves profit by enhancing efficiency gains and reputational benefits but on the other hand it may reduce ROA due to initial cost for adopting Environmentally friendly practices. The Governance score showed a positive influence on the ROA, due to increased efficiency on assets-based returns but a negative impact on profit margin, this could be due to heavy compliance or administrative cost. The social factor does not show any significant impact on financial performance. Thus, overall findings highlight the importance of sustainability goals by ensuring ESG practices align with both business success and long-term financial growth.

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CHAPTER ONE

INTRODUCTION

Chapter 1 - Introduction

The interest in Environmental, Social, and Governance (ESG) continues to gain momentum globally. The Paris Climate Agreement and steps taken by regulatory bodies, like the European Union (EU), mandating ESG reporting for large and publicly listed companies have further amplified the focus on ESG.

The GCC Exchanges Committee has also advanced this agenda by publishing standardized ESG Disclosure Metrics, serving as a guideline for GCC companies. These standardized metrics increase the clarity at which companies who choose to report can. It also increases the ease at which stakeholders can understand what is been reported. The UAE remains the only country in the GCC and one of the few countries globally that have mandated ESG reporting for public companies.

As a result of all these developments, the talk around the importance of ESG and its reporting, whether as a mandate, regulatory requirement, or an evolving market trend, continues to spread more than ever before (Goldstein, Kopytov, Shen & Xiang,2022).

Why do companies strive to reach ESG goals? Are ESG reports just a distraction from an organization's main objective of maximizing returns on investments? Or does ESG indeed contribute to financial performance?

The financial sector continues to be a key contributor to ensuring ESG goals are met. With investors and banks' growing preference for sustainable investments (Pástor, Stambaugh & Taylor, 2021) and other non-financial metrics like board composition (Arayssi, Jizi, Tabaja,2020), companies recognize the opportunity in ESG. Additionally, resource efficiency due to innovative solutions to meet sustainability goals could also contribute to cost cuts, which could impact companies' profitability eventually.

Studies related to sustainability have become a critical area for researchers and industries in recent years. The world faces various social and environmental challenges due to the growing global population and rising climate change. (Nasruzzaman Naeem, December 2022).

Companies must not only focus on value creation and profit maximization but should also serve the best interest of their stakeholders by incorporating Environmental, Social, and Governance factors, as this would enable them to build stronger relations with their stakeholders such as customers, suppliers, shareholders, and their employees. (Freeman, as cited by (Nasruzzaman Naeem, December 2022,) which could potentially lead back to financial and social gains for the company.

The UAE, traditionally known for its oil and petroleum wealth, is at a pivotal crossroads as it seeks to transition towards a green economy. This shift is both a response to global climate initiatives and a strategic move to diversify their economies and reduce dependency on oil revenues.

The region faces challenges in balancing rapid economic development with sustainable practices. As a result, integrating ESG factors into corporate strategies has become increasingly important. These efforts reflect a broader ambition to position the UAE as a leader in sustainable development, attracting international investments and fostering long-term economic stability amidst a global shift towards more sustainable and responsible business practices.

Organizations report using various ESG metrics that stakeholders, such as investors and analysts, use to assess risk and opportunities. Companies can benefit by comparing these metrics and identifying areas of improvement in sustainability and ethical practices.

ESG factors have been contributing to the organization's success. These factors enhance the organization's reputation, leading to brand loyalty and shareholder value.

Businesses in the UAE have no choice but to align with the set goals of the government. But it could also be extremely beneficial for them eventually. This research seeks to examine the influence of specific ESG variables on the financial performance of companies across diverse industries, with a particular focus on firms in the UAE.

It aims to evaluate how establishing and achieving ESG goals can significantly impact short- and long-term outcomes, such as obtaining financial incentives and enhancing corporate reputation.

Research Question

What is the impact of ESG factors on the financial performance of organizations in the UAE?

Research Objectives

To assess the direct and indirect effects of each ESG factor (Environmental, Social, Governance) on financial outcomes in different industries within the UAE.

To investigate the regulatory and market-driven incentives for companies in the UAE to adopt ESG practices.

To analyze the role of corporate governance in balancing financial performance with ESG priorities.

Structure of Research

The articulation of the research is comprised of five organized chapters. **Chapter 1** describes the research problem, the key questions, and the objectives, all of which lay the groundwork for the study. Review of associated literature, identification of research gaps, and hypothesis development based on theoretical perspectives are done in **Chapter 2**. **Chapter 3** contains the research methodology, the data collection, and analysis techniques to ensure the validity and reliability of the study. **Chapter 4** presents the findings collected, analyzes them, and relates them to the objectives and hypotheses of the study. Lastly, **Chapter 5** wraps up the research, summarizing the findings, discussing the implications, making recommendations, and listing all the references used in the work.

CHAPTER TWO
LITERATURE REVIEW

Chapter 2 - Literature Review

Theories

Stakeholder theory

Stakeholder theory focuses on an interconnected system of value-creating relationships involving groups with a significant stake in the firm's activities and outcomes (Pies & Valentinov, 2024). It is a managerial concept used to examine how effectively a company manages its shareholders to achieve its corporate performance goals (Talan et al., 2024). These stakeholders span from those with direct investment in an organization to intermediaries who safeguard stakeholders' interests and external regulators who establish controls to keep organizations accountable.

Although the various stakeholders have distinct levels of influence on the company, and most companies' priorities lie in their shareholders and customers, society at large and the environment ought to be given similar attention as they also contribute to an organization's value (Talan et al., 2024).

For example, a company's externalities, positive and especially negative, affect more than those directly benefiting from the company. These externalities sometimes cause lasting damage and harm to people and the planet and even affect a company's profitability. Hence, collaborative efforts with regulatory agencies and environmental organizations could result in significant environmental, social, and governance benefits, positively influencing all stakeholders and ensuring long-term sustainable value creation.

Agency Theory

Agency theory is used by managers to analyze and structure their relationship networks, particularly the importance of managing behavioral uncertainty. The theory focuses on the relationship between principals (shareholders) and agents(management), where both sides aim to maximize their own benefits (Lundberg, 2022) (Partyka, 2022), often leading to conflicting interests.

The theory supports managerial decision-making focused on strategies that promote incentive alignment and transparency, ensuring that agents act in ways that serve stakeholders' interests (Lundberg, 2022). Governance practices are crucial in making sure that managers are acting in ways that uphold shareholder value and drive long-term profitability. However, when managers prioritize their own agendas (Zhang, Zheng & Shan, 2024), such as concealing detrimental news or overinvesting in sustainability to boost their reputation, these actions can negatively affect the company's financial health.

Research has demonstrated that firms heavily involved in sustainability initiatives were more prone to stock price crashes during the COVID-19 pandemic (Zhang, Zheng & Shan, 2024). This evidence aligns with agency theory, suggesting that sustainability efforts are being misused to cover up mediocre performance, thereby increasing risk. This increases the level of necessity for governance practices that balance sustainability pursuits with the general goal of long-term profitability and value creation.

Institutional Theory

Institutional theory highlights that organizations tend to bend to not only formal regulations but also informal norms, values, and beliefs of their institutional environment (Xing, Yalçin & Daim, 2024). This alignment often secures legitimacy, placing organizations in an influential position within their network, which could be beneficial in areas of operational efficiency.

Companies' actions often reflect a response to institutional pressures, where behaving in socially accepted conventions grants them a competitive edge as this legitimacy influences the level of support and trust the organization receives from various stakeholders (Xing, Yalçin & Daim, 2024), directly influencing long-term profitability and stability.

Apart from achieving legitimacy, organizations must strategically manage their external resources to ensure survival and success. To do this, they must maintain their ecosystem's favor. By balancing resource optimization with institutional alignment, organizations can remain resilient and competitive.

However, the downside of this alignment is that companies may present a facade of compliance and shared values without adhering to the principles upon which they built their legitimacy in their institutional environment. This could include manipulating reports to appear compliant while all actual practices remain unchanged. Such cases are highly misleading to stakeholders, but there are also arguments that shareholders' expectations are simply too high.

Introduction to Environmental, Social and Governance (ESG) Factors

The interest in Environmental, Social, and Governance (ESG) continues to gain momentum globally. The Paris Climate Agreement, steps taken by regulatory bodies, countries mandating ESG reporting for large and publicly listed companies, and influences of institutional investors have further amplified the focus on ESG (Newell, 2023). As its importance rises, so does the scholarly interest in the economic consequences of this growing phenomenon (Chen & Zhang, 2024).

ESG factors influence corporate performance in positive and negative ways. They serve as a framework for evaluating the sustainability and social effects of a company's operations (Li, Wang, Sueyoshi, Wang, 2021). However, there are concerns. Increased concentration on ESG issues may lead to overinvesting in these aspects at the expense of shareholders (Nguyen, 2024), which aligns with the agency theory. In the quest to improve ESG scores, more costs are incurred, which could affect the performance, especially the short-term performance of a company (Chen & Zhang, 2024) (Hu, Hassan & Atif, 2024).

ESG scores are what stakeholders use to judge the ESG performance of companies and what companies strive to improve to attract potential investors. However, the metrics in which these ESG scores are measured are also called into question. With different companies using different metrics, it is hard for stakeholders to make comparisons among companies (Kartal et al., 2024), as these ESG scores may not truly represent the ESG performances of these companies (Hu, Hassan & Atif, 2024). For this reason, certain metrics have been published to standardize the scoring and serve as a guideline for ESG disclosures.

There is also a matter of size when it comes to ESG reporting and performance. Larger companies have more access to resources and data to boost their ESG scores (Hu, Hassan & Atif, 2024). A company's size, however, does not necessarily make them more ESG-conscious.

Studies have also shown controversies around how ESG should be measured and how they are being measured. Some found that factors like sales, return on equity, dividend yield, etc.., of companies played a huge part in determining their ESG scores (Kartal et al., 2024). Other studies suggest that it is more important to analyze the strategic planning, actual business activities (Hu, Hassan & Atif, 2024), and even news events (Kartal et al., 2024) of companies to predict ESG scores and some still argue that there a still a lot of unmarked variables that are still left unmeasured that contribute to the ESG performance of a company. Also, with some companies engaging in Greenwashing (Hu, Hassan & Atif, 2024) to improve the ESG scores, appealing to institutional theory, as there are a lot of economically beneficial motives, it is difficult to determine if these scores are accurate enough or completely misleading.

Environment (E)

Human activities, such as deforestation and fossil fuel combustion, are accelerating the increase of carbon dioxide and greenhouse gases, driving climate change impacts like rising sea levels, melting ice caps, and severe droughts. Ocean pollution from industrial and plastic waste is also disrupting marine ecosystems, contributing to an environmental imbalance.
These concerns highlight the urgent need for responsible business practices and lifestyle adjustments that align with the planet's sustainability needs. Sustainable living emphasizes reduced exploitation, energy conservation, and ethical practices, encouraging a balanced human-environment relationship. These practices ensure harmony between environmental preservation and economic development, balancing our current needs with future generations' well-being. (Gadotti, 2008)

The "**E**" has gathered the most attention of all, with the issue of sustainability and climate change being the most talked about. 7% of executives who took part in the PwC's 2024 Annual Corporate Directors Survey agreed that ESG is the same as sustainability.

While that is not the case, the danger that climate change poses to the planet, along with the significant role companies and industries play in contributing to it, has heightened the focus on this issue. This has led to increased regulations at all levels of the supply chain.

The reduction of carbon emissions and footprint of enterprises, increase in the ratios of renewable energy used, energy utilization (Hastalona & Sadalia, 2021) (Hu, Hassan, & Atif, 2024), resource optimization, waste management, ecosystem protection and continued sustainable innovation and development are areas where companies are expected to focus. All these efforts made by companies to improve their practices towards the environment properly align with stakeholder theory.

These initiatives, however, incur additional costs which affect corporate financial performance. (Hu, Hassan, & Atif, 2024). On the other hand, they can also contribute to corporate financial performance. Recycling, avoidance of fines and cost of cleaning up improper waste disposal, efficiency in resource use, and reduced financing costs, i.e., the Glasgow Financial Alliance for Net Zero, could contribute positively to the financial performance of organizations. These benefits are actual incentives that could drive companies to do better, which is in line with the institutional theory that emphasizes that companies' actions often reflect a response to institutional pressures.

Social (S)

Diversity, equity and inclusion, health and well-being, supply chain management, and customer satisfaction have been key topics of discussion in relation to the culture within any organization in recent years.

Social issues of under-representation in the workplace today, such as gender equality, cultural diversity, and inclusiveness, are often gauged by stakeholders. It is key to creating a fair and balanced working environment. The flow of ideas from people of different genders, age groups, races, and backgrounds often brings a variety of perspectives that lead to more innovative solutions, be it on the board or at the lowest level of the organization.

COVID-19 played a huge role in more emphasis being placed on the health and well-being of the organization's workforce. The mental and physical well-being of employees and a great work-life balance directly affect the effectiveness and efficiency of employees in their daily duties.

Organizations are starting to invest more in their commitment to creating a healthy working environment. These could reduce the rate of absenteeism, increase employee performance, and attract top talents in the industry (Newell, 2023), which appeals to the stakeholder theory.

Supply chain management is also a critical area, especially concerning fair pay, labor rights (Kartal et al., 2024), and the prevention of child labor and modern slavery (Newell, 2023). Ignorance is no longer an excuse. Organizations are being held to the highest standards and must ensure that their supply chains operate in a socially responsible manner, appealing to the institutional theory, where a company maintains legitimacy by behaving in socially acceptable conventions. Stakeholders and whistle-blowers are paying close attention to these issues, and reports of bad practices could be especially damaging to an organization's reputation. Cancel culture and boycotting have also grown in recent years, so some companies suffer significant blows in their financials when exposed.

Customer satisfaction is important when it comes to evaluating a company's social impact. Satisfied customers are a sign of good business practices, responsiveness, and transparency. Ensuring that products and services provided are of high quality and are ethically produced is a growing expectation of stakeholders. Companies that prioritize ethical business practices, customer feedback, and fair marketing are seen in a better light. Poor customer satisfaction, on the other hand, could lead to negative publicity and a loss of trust in the company, which harms a company's social standing and financial performance.

<u>Governance (G)</u>

Historically, governance has been the most established component in ESG. This is due to the longstanding involvement of regulatory authorities and governments in shaping corporate governance and legal frameworks (Newell, 2023). Organizations are expected to align their strategies, performance goals, and management's accountability with both shareholder interests and the established regulatory and ethical standards set by relevant authorities.

Corporate Governance Structure, Board Accountability, Compliance & Regulatory Adherence, Ethics & Transparency (Newell, 2023), Risk Management, Data Protection, and Cybersecurity are key governance factors. While some of these have been important since the invention of companies, the rise of internet-age security risks has brought new priorities, such as cybersecurity and data protection, to the forefront. In today's world, where significant harm can be caused by mishandling data collected by companies, cybersecurity, and data protection have become top priorities for most businesses.

Financial considerations such as executive compensation and the minimum level of dividend payouts are crucial to shareholders. Additionally, a company's involvement in political donations may be scrutinized by shareholders and other stakeholders, given the potential for conflicts of interest and the broader impact of the associated public policies. Potential investors and stakeholders are also keen on governance issues like bribery, corruption, adherence to labor laws, and shareholder rights.

Governance serves as the basis of agency theory, and addressing the challenges that pose a risk to balancing the dynamics between shareholders (principals) and company management (agents) remains a topmost priority.

A strong governance framework also ensures that CSR initiatives are not mere marketing strategies but are deeply integrated into the company's business practices. Regulations that drive corporate transparency and accountability are essential for maintaining trust with stakeholders. Companies must adopt comprehensive governance measures to uphold ethical standards (Kartal et al., 2024) and fulfill their fiduciary responsibilities. Studies have emphasized the effectiveness of robust governance structures, demonstrating that well-structured governance safeguards a company's operations and reputation, fosters better stakeholder relationships, and promotes long-term value creation.

ESGs increase the organization's value in terms of reputation, risk management, and long-term sustainability. However, there seem to be mixed reviews when it comes to its impact on the financial performance of companies. Firms that incorporate ESG, aligning corporate strategies with regulatory requirements and societal expectations, tend to attract more responsible investors and are even acquired for more. They also reduce regulatory risks. However, the cost of implementing ESG strategies may outweigh the financial benefits. These measurements are heavily impacted by industry-specific factors and the stage of implementation that an organization is at while being examined.

Impact of ESG Factors on the Financial Performance in the GCC Firms

Though our study is particularly conducted on the impact of ESG factors on the financial performance of UAE companies, in this section, we will provide a general overview of the impact of environmental, social, and governance (ESG) factors in GCC countries.

The Gulf Cooperation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and UAE), traditionally known for their wealth in fossil fuels, are at a pivotal crossroads as they seek to transition towards a green economy. This shift is both a response to global climate initiatives and a strategic move to diversify their economies and reduce dependency on oil revenues.

The region faces challenges in balancing rapid economic development with sustainable practices. As a result, integrating ESG factors into corporate strategies has become increasingly important.

These efforts reflect a broader ambition to position the GCC as leaders in sustainable development, attracting international investments and fostering long-term economic stability amidst a global shift towards more sustainable and responsible business practices.

ESG factors are comparatively new in the GCC countries. These factors have shown potential growth in the last 6 years. NGOs and stock exchange regulators such as the Saudi Exchange, Abu Dhabi Securities Exchange, Dubai Financial Market of the UAE, and The Muscat Stock Exchange of Oman, among others, have pushed companies to adopt and disclose ESG practices. Historically, companies in the GCC regions have been slow in adopting ESG practices; this could be due to heavy dependency on oil and gas revenue. Eventually, governments in these regions have come to recognize the importance of sustainability and long-term growth (Ahmad,2022) (Bamahros et al., 2022).

A study by Sharma et al. (2022) investigated the impact of ESG reporting on firm performance and the relationship between ESG disclosure and firm performance in the GCC-listed companies. The study sample included 91 firms from 6 GCC countries, analyzed over 2019, 2020 and 2021. The study found that environmental, social, and governmental scores positively correlated with market capitalization and negatively correlated with return on assets. The environmental variable, however, had a positive but weak relationship with ROA. The reason could be due to the cost of implementing ESG practices that do not necessarily show immediate profitability.

The study also revealed that the overall ESG score, and governance factor significantly impacted the companies' market value in terms of market capitalization, aligning with the institutional theory as the demand for ESG investments by investors has increased in recent years.

Overall, the governance factor consistently reflected positively on market valuation and profitability. This suggests that GCC countries perform better with high governance structures, and GCC investors value this trait. However, another study by Ahmad, Z. (2022) revealed that governance factors do not significantly impact an organization's value. This could be due to mandatory high-level governance reporting enforced by law in the GCC countries.

In the same light, governance factors have significantly impacted ROA and ROE as measures of financial performance. This reflects the importance of suitable governance structures (Alghafes et al., 2024).

Social factors have a positive impact on financial performance. Still, they are less significant compared to the governance factor in terms of improving ROA and ROE. This study examining how Environmental, Social, and Governance (ESG) practices impact the performance of Islamic banks in GCC countries highlighted the ethical principles of Islamic banks that emphasize social equality and ethical fairness (Alghafes et al., 2024). The environmental factor, however, showed less significant impact on the bank's financial performance, which could be due to the underdevelopment of green finance in the GCC banking sector.

Studies have also highlighted that ESG factors are more associated with market-based metrics like share price appreciation than accounting-based metrics (Ahmad, Z, 2022). Thus, higher ESG performance leads to higher market value in the GCC.

Studies, however, vary by industry. Alghafes et al. (2024) showed that overall, ESG had no significant impact on the financial outcome of the financial institutions in the GCC. However, individual ESG factors have played a significant role in predicting financial performance.

The Effect of ESG Disclosures on the Financial Success of UAE-Listed Businesses

ESG declarations regarding how they affect financial performance have lately gained popularity, particularly in emerging markets such as the UAE. As the world swings towards sustainability and ethical investment, enterprises and financial firms are increasingly evaluated not just on their profitability but also on their ESG operations.

A research project by Salman Abdullah S. Alshehri (2024) examined how ESG disclosures impact the financial outcomes of listed corporations in the UAE. This research looked at a sample of 51 businesses that were listed on the Abu Dhabi Securities Exchange (ADX) between 2020 and 2023. Following the implementation of the UAE's Corporate Governance Code and new environmental reporting laws, these companies are mandated to submit ESG-related data.

The findings revealed a favorable and substantial relationship between environmental and social disclosures and financial success, as measured primarily by return on assets (ROA) and return on equity (ROE). Firms that freely discussed their environmental impact and social responsibilities tended to do well financially.

However, Governance disclosures showed a negative but statistically insignificant link with financial performance. Even though good governance is crucial for fostering transparency and accountability, the research does not show that disclosure of governance information directly benefits companies financially.

This significance originates from legislation prioritizing governance procedures in the UAE, making governance the most emphasized component of ESG disclosures. Other studies also consider companies' struggles in trying to figure out how to balance transparency with smart governance practices.

Building on a recent study, Zaman and Ellili (2022) investigated the impact of ESG performance on the financial outcomes of UAE banks. The research spanned from 2014 to 2019 and scrutinized five UAE banks listed on the Abu Dhabi Securities Exchange (ADX) and the Dubai Financial

Market (DFM). Similarly to the earlier investigation, this study revealed that ESG performance positively impacts financial returns, especially concerning ROA and ROE. The authors stressed that the UAE banking industry is still developing a comprehensive ESG strategy. This improvement is driven by both local rules and global environmental efforts.

Furthermore, the study found that while applying ESG principles incurs some early costs, the benefits eventually outweigh the expenditures. These include boosted profitability, diminished risks, and improved reputational worth. The study's outcomes bolster the notion that banks, despite their limited direct environmental influence, can enhance their financial performance via responsible ESG actions such as cutting operational waste and prioritizing employee diversity & governance. Furthermore, banks indirectly foster good change by providing preferred lending terms such as reduced interest rates, longer payback periods, or flexible loan structures to firms that actively incorporate sustainability and ESG practices into their operations. Banks not only assist firms that use responsible practices, but they also push other businesses to follow ESG norms. This method combines financial incentives with sustainability, creating a market environment in which responsible businesses enjoy a competitive advantage in financing, accelerating the transition to a more sustainable economy.

Nguyen and Nguyen (2024) mentioned another significant industry as an example of how to understand the impact of Environmental, Social, and Governance (ESG) factors on real estate performance. The industry is sensitive to market stability and regulations, making it a perfect example for assessing the influence of ESG reporting.

Nguyen’s Research examines how ESG activities affected real estate companies’ financial measures before and after the COVID-19 pandemic. They compared firms with high and low ESG measures for two periods, which are pre-pandemic (2016-2019) and post-pandemic (2020-2022), using a panel data approach and Difference-in-Differences (DID) model. They examined the flexibility and financial performance of firms based on their ESG combination, with specific importance on abnormal returns, price-to-earnings (P/E), price-to-book (P/B), return on equity (ROE), and stock instability.

The outcomes of this study reveal that ESG elements improve business performance during disasters, as firms with high ESG scores had superior capital performance and recovery rates compared to enterprises with low ESG ratings.

These studies emphasized several crucial features of ESG disclosures and financial success. First, environmental and social disclosures have consistently favorable effects on financial success. This follows global trends in which investors and stakeholders are increasingly choosing companies that exhibit environmental and societal responsibility. Companies in the UAE that prioritize sustainable practices and social contributions have not only enhanced their reputation but also reaped major financial benefits, as evidenced by their ROA and ROE.

On the other hand, governance disclosures reveal a more intricate scenario. In both examinations, governance disclosures either lacked significant influence or negatively correlated with financial performance. This indicates that while effective governance is crucial for long-term sustainability, focus on governance may not directly yield immediate financial benefits. This might stem from the additional expenses and administrative challenges tied to governance compliance.

Finally, both investigations underscore the growing importance of ESG revelations in the UAE. This is fueled by local regulatory bodies and global sustainability initiatives. The UAE administration has strongly advocated for sustainability programs, notably the Abu Dhabi Sustainability Group and several green councils. These actions have led to a slow yet steady uptick in ESG reporting among businesses in the UAE, making them appealing investment prospects for socially responsible investors (SRI). Nevertheless, as both analyses indicate, there are still many opportunities for advancing governance clarity and weaving ESG disclosures into additional sectors, especially private enterprises.

To summarize, the research shows that ESG disclosures, particularly in the environmental and social sectors, may significantly improve financial performance in the UAE. While governance is certainly important, the impact on financial success shows no substantial differences. These results provide crucial insights for UAE-based businesses and financial institutions as they strive to improve their approaches to sustainable and economic results. These benefits encourage executives who want to create a more sustainable economic structure. Simply put, ESG disclosures are essential and can alter the financial environment while promoting a healthier future.

Research Gap

On conducting a literature review, we noticed that a majority of existing studies on ESG factors focus on the broader GCC region. A few papers narrowed in on the UAE specifically, which leaves a gap in understanding the unique context of the UAE's corporate environment.

Additionally, most UAE-based research tends to concentrate on specific industries, with many being based on banking and real estate, limiting the broader applicability of findings to other sectors. Furthermore, while substantial attention has been given to the environmental aspect of ESG, with some focus on governance, there is a notable lack of research exploring the social dimension of ESG within the UAE. This gap in the social aspect further highlights the need for a more comprehensive study of ESG factors. Most studies also primarily examine the pre-COVID or during-COVID periods, making my focus on the years 2019 to 2023 particularly relevant as it offers a more recent perspective that might better reflect the evolving trends in ESG integration.

CHAPTER THREE
RESEARCH METHODOLOGY

Chapter 3 - Research Methodology

The study aims to analyze the impact of ESG factors on the financial performance of companies, especially in the UAE. To achieve this, a hypothesis testing approach was implemented based on the proofed literature and the databases used, such as Emerald, Scopus, Google Scholars, ScienceDirect, and ProQuest, to recognize similar research on ESG factors and financial performance.

The study includes data representing different sectors in the UAE; there are nine companies listed in the Abu Dhabi Securities Exchange that vary in the industry, including banking, real estate, telecommunications, petroleum and gas, and transportation & logistics.

In this way, the research drew upon data from 9 companies, with a time span of 5 years and 6 different variables for every single company-year observation, producing the following sample size:

$$\textbf{\textit{Sample Size = Number of Companies}} \times \textbf{\textit{Years}} \times \textbf{\textit{Variables}}$$

$$\textbf{Sample Size} = \mathbf{9 \times 5 \times 6 = 270}$$

Thus, the final sample size employed in this study forms a 270-point dataset ensuring stronger data for statistical analysis.

The secondary data is categorized into two groups, financial data and non-financial data, to evaluate the impact of ESG factors on financial performance as follows:

- Financial Data – financial statements from 2019 to 2023, which include income statements and statements of the financial position of the companies.

- Non–financial Data – ESG reports from 2019 to 2023 include ESG scores and the scores for each component (Environmental, Social, and Governance).

A thorough examination of the connection between ESG implementation and financial performance in the UAE was made possible by the division of businesses into discrete categories. This method made it possible to comprehend the effects of different degrees of ESG integration on financial results more clearly. Refinitiv provided trustworthy data that included important measurements for financial performance parameters including profitability, market value, and operational efficiency as well as ESG considerations.

The investigation used Jamovi, to assess the relationship between ESG elements (environmental efforts, social responsibility, and governance standards) and financial success. This contributed in the discovery of trends and patterns, resulting in practical knowledge into how ESG practices improve financial performance. These findings have practical implications for firms trying to improve their ESG strategy and authorities looking to promote environmentally friendly habits across businesses in the UAE.

Variables Used for Analysis

Type of Variable	Name of Variable
Independent Variables	Environmental Factor, Social Factor & Governance Factor.
Dependent Variables	Profit Margin and Return on Assets (ROA).
Control Variables	Total Assets and Organization Size.

The study aims to assess the link between ESG elements (Environmental, Social, and Governance) and financial performance in UAE companies. ESG components were chosen as **independent variables** because they reflect important aspects of sustainable and responsible company practices that are thought to influence financial results.

Profit Margin and Return on Assets (ROA) are used as **dependent variables** to assess financial performance because they adequately represent a company's profitability and resource use efficiency.

To guarantee that the results are not influenced by external sources, **control variables** such as Total Assets are included. We incorporate Total Asset as a control variable as it is a good measure of Organizational Size. These variables adjust for variances in business scale and operations, ensuring that the observed impacts are predominantly caused by ESG issues rather than differences in size or resource availability. This organized methodology enables the study to present a clear and focused examination of how ESG practices affect financial performance in UAE firms.

Model

The analysis model was formulated as follows:

Financial Performance (ROA, Profit Margin) = β0+ β1Envscore1 + β2Socialscore2+ β3Govscore3

Hypothesis

1. Environmental Factors on financial performance
   H1: Environmental factors positively impact the financial performance of companies in the UAE.

   H0: Environmental factors negatively impact the financial performance of companies in the UAE.

2. Social factor on financial performance
   H2: Social factors positively impact the financial performance of companies in the UAE.

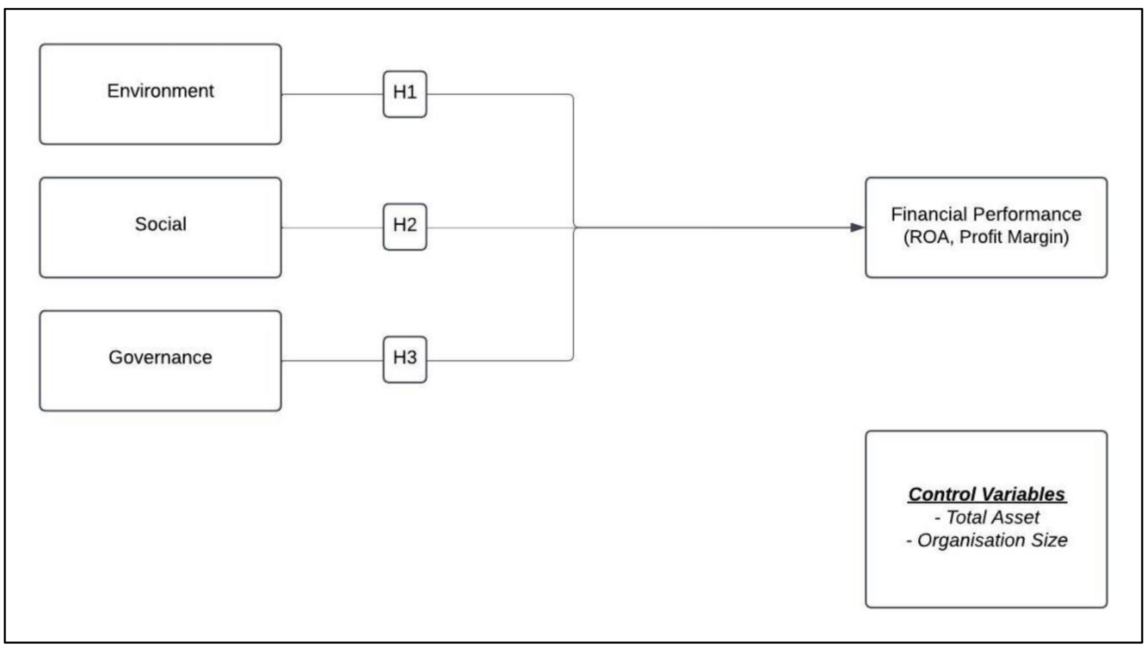
   H0: Social factors negatively impact the financial performance of companies in the UAE.

3. Governance factor on financial performance

   H3: Governance factors positively impact the financial performance of companies in the UAE.

   H0: Governance factors negatively impact the financial performance of companies in the UAE.

Conceptual Framework



CHAPTER FOUR
DATA ANALYSIS

Chapter 4 - Data Analysis

The data analysis consists of the environmental score, social score, and governance score being the independent variables, and the dependent variables are financial metrics such as ROA and profit margin as a measure of the firm's financial performance. Total assets of the companies are the control variables for the analysis.

Descriptive Statistics

	N	Missing	Mean	Median	SD	Minimum	Maximum
Environment Score	45	0	52.4722	51.0000	20.4049	19.0000	85.000
Social Score	45	0	53.8000	56.0000	20.4632	3.0000	89.000
Governance Score	45	0	60.0056	65.0000	22.0476	15.0000	95.000
ROA	45	0	0.0752	0.0520	0.0618	0.0110	0.226
Profit Margin	45	0	0.2912	0.2300	0.2076	0.0230	0.728
Total Assets	45	0	1,790,000	132364	4,620,000	5399.9	16,018,434

Total Assets amount in Thousands

TABLE 1

The above table shows the descriptive statistics of the variables. The Environmental score has a mean of approximately 52.47 with a standard deviation of 20.40. The minimum score is 19, and the maximum score is 85. The social score has a mean of 53.80, with an SD of 20.46. The minimum score is 3, and the maximum score is 89. The governance factor has a mean of 60.00 with an SD of 22.04. The Score ranges from 15 to 95.

The financial metrics such as ROA and Profit margin mean about 0.08 and 0.30 with SD of 0.06 and 0.21, respectively.

The control variable (Total Assets) has a mean of approximately 1,790,000 with an SD of 4,620,000. The minimum Total Asset being 5399.9, and the maximum is 16,018,434

Correlation Matrix

	Environment Score	Social Score	Governance Score	ROA	Profit Margin	Total Assets
Environment Score	—					
Social Score	0.664	—				
Governance Score	0.110	0.502	—			
ROA	-0.327	-0.115	0.379	—		
Profit Margin	0.254	-0.093	-0.603	-0.561	—	
Total Assets	0.205	-0.024	0.049	0.476	-0.286	—

The Environmental score has a negative moderate correlation of -0.327 with ROA significant at ($p<0.05$). The Social score has an insignificantly weak negative correlation of -0.115 with the ROA. Which indicates there is no meaningful association between social score and asset-based return. However, the governance score has a significant positive moderate correlation of 0.379 with ROA at $p<0.05$. Suggesting that governance score might positively influence returns on assets.

The Governance score has a strong negative significant correlation of -0.603 with profit margin. This indicates that higher governance practice may result in lower profitability in the short run due to investment in risk management or stakeholder engagement. The social score has an insignificantly weak negative correlation of -0.093 with the profit margin. While the environmental score has a positive insignificant weak correlation (0.254) with profit margin.

The profit margin has a significant negative association of -0.561 with ROA. This might indicate that companies that focus on maximizing asset-based returns can have smaller profit margins.

The Total asset has a significant positive correlation of 0.476 with ROA. Indicating a better and more efficient use of assets to generate returns.

The environmental score and governance score have a strong, significant positive correlation of 0.664 and 0.502 with a social score, respectively.

Collinearity Statistics (VIF Table)

	VIF	Tolerance
Environment Score	2.30	0.435
Social Score	2.92	0.342
Governance Score	1.57	0.635
Total Assets	1.14	0.878

The above table represents the multicollinearity statistics. This test is used in our analysis to detect multicollinearity issues. The value for VIF is below 5%, which indicates a moderate correlation.

Linear Regression (ROA)

Model Fit Measures

				Overall Model Test			
Model	**R**	**R^2**	**Adjusted R^2**	**F**	**df1**	**df2**	**p**
1	0.760	0.577	0.535	13.6	4	40	< .001

Model Coefficients - ROA

Predictor	Estimate	SE	t	p
Intercept	0.07139	0.0236	3.028	0.004
Environment Score	-0.00157	0.000473	-3.324	0.002
Social Score	0.000153	0.000531	0.289	0.774
Governance Score	0.00107	0.000362	2.967	0.005
Total Assets	7.55e-9	1.47e-9	5.143	< .001

Linear Regression (Profit Margin)

Model Fit Measures

				Overall Model Test			
Model	**R**	**R^2**	**Adjusted R^2**	**F**	**df1**	**df2**	**p**
1	0.762	0.581	0.540	13.9	4	40	< .001

Model Coefficients - Profit Margin

Predictor	Estimate	SE	t	p
Intercept	0.46010	0.07874	5.843	< .001
Environment Score	0.00487	0.00158	3.087	0.004
Social Score	-0.00135	0.00177	-0.762	0.450
Governance Score	-0.00538	0.00121	-4.450	< .001
Total Assets	-1.61e−8	4.90e-9	-3.294	0.002

	t-Statistic	p-value	r-square
H1	-3.324	0.002	0.577
H2	0.289	0.774	0.577
H3	2.967	0.005	0.577

Dependent Variable - ROA

	t-Statistic	p-value	r-square
H1	3.087	0.004	0.581
H2	-0.762	0.450	0.581
H3	-4.450	< .001	0.581

Dependent Variable – Profit Margin

The above tables display the regression analysis with dependent variables (ROA and profit margin) and independent variables (Environmental score, Social score, and Governance score). The control variable being the Total assets. The p-value is less than 0.05, suggesting the overall model is statistically significant. For Table 1, we find the r-square is 0.577, which means 57.7% of the variance in the ROA is explained by the combined effect of environmental, social, and governance scores, while Table 2 has an r-square of 0.581, suggesting 58.1 variance in profit margin is explained by the combined effect of Environmental, social and governance score. The findings of our regression analysis for ESG factors display mixed results based on different financial performance metrics being used.

Discussions in Analysis

In this study, we focused on the individual ESG pillars rather than the overall ESG scores. As emphasized in previous studies, ESG scores may have a significant impact on market value and capitalization, but there is limited substantial evidence that they have a clear impact on financial performance, especially when using profitability metrics such as ROA and ROE. Our research aims to identify how the three pillars, Environmental, Social, and Governance, individually influence profitability using ROA and Profit Margin as our financial metrics. This focus aligns with stakeholder, agency, and institutional theory, looking into how effective ESG practices could be financially beneficial to organizations while benefiting their ecosystem. It points out the need to study whether ESG factors contribute to profitability, apart from the creation of greater social good.

E in ESG

The findings of our research revealed both alignments and contradictions with previous studies. For the Environmental pillar, our analysis showed a significant negative moderate correlation with ROA and a weak correlation with profit margin, suggesting that although organizations may improve their environmental initiatives, such actions may be at the expense of immediate asset returns and operational efficiency. Although often praised for its long-term sustainability benefits, the E in ESG might not align with the short-term profitability goals of a company; this may be due to the initial investments or expenses of transitioning an organization to a more eco-friendly unit.

Our findings are in sharp contrast with prior research in GCC that reported a weak but positive association with ROA (Sharma et al., 2022) and UAE-based studies that reported strong positive associations with both ROA and ROE (Alshehri, 2024). The divergence questions whether the perceived financial benefits from environmentally conscious practices are overstated or context-dependent, especially when profit margins, a key indicator of operational success, seem largely unaffected or even negatively impacted.

From the agency theory perspective, such a negative relation could mean that the interests of management (agents) and shareholders (principals) are not aligned. Management may focus on environmental initiatives to enhance reputation or comply with pressures from regulators and societal pressures, aligning with institutional theory (Xing, Yalçin & Daim, 2024), even though such initiatives may eventually jeopardize the short-term returns desired by shareholders (Partyka, 2022).

In relation to the institutional theory, the discrepancies may be due to the different regulatory frameworks, cultural expectations, and institutional pressures (Xing, Yalçin & Daim, 2024) that apply in GCC and UAE compared to other contexts that may influence the implementation and perception of environmental initiatives.

S in ESG

The social pillar showed the least tangible contributions to profitability, with a weak correlation to ROA and little to no correlation with profit margin. This is in line with the skepticism put forward by some studies on the quantifiable benefits of social initiatives. While GCC literature suggested a negative relation with ROA (Sharma et al., 2022), it simultaneously argued for a less significant but positive overall financial impact; similarly, UAE-based studies explicated significant positive relations with ROA and ROE (Alshehri, 2024), which are in direct contrast with our findings. This raises an important concern in ESG research: inconsistent measurement and contextual interpretation of social factors. It may, therefore, mean that such social investments pay off only under certain conditions, for example, where there is strong alignment with a firm's strategic priorities or regional expectations, begging the question of their universal applicability to profitability.

Both the institutional theory and the stakeholder theory come into play here. It explains how varied societal norms and stakeholder expectations (Xing, Yalçin & Daim, 2024) (Talan et al., 2024) in different parts of the world may create a drive to participate in good social practices regardless of financial outcomes.

G in ESG

The Governance pillar provided us with mixed results. On the one hand, we found a relatively strong positive correlation with Return on Assets (ROA), indicating that strong governance structures may bring better asset efficiency and returns. On the other hand, a significantly strong negative correlation with profit margin was recorded, suggesting potential inefficiencies in converting governance improvements into broader profitability gains.

This duality raises very important questions related to operational challenges of governance reforms, such as increased administrative costs or overly rigid compliance measures, which could outweigh financial benefits. In previous GCC studies, governance has also shown mixed results. Sharma et al. (2022) reported that governance had a negative correlation with ROA. However, a study by Ahmad, Z. (2022) showed a significant positive effect on ROA and ROE, emphasizing the importance of a good governance structure (Alghafes et al., 2024), though it had no significant impact on market value. Similarly, UAE-based research described its financial influence negatively, though statistically insignificant (Alshehri, 2024). These are opposite findings, challenging the assumption that good governance necessarily leads to immediate gains in finance since it might introduce inefficiencies or raise costs or rigidities that offset the benefits in the short run.

Governance generally aligns with agency theory. Effective governance mechanisms are in place to reduce the potential conflict between shareholders and management through the assurance of accountability (Lundberg, 2022) (Partyka, 2022); however, this may increase compliance costs or stricter oversight, which may negatively impact profit margins.

CHAPTER FIVE FINDINGS & CONCLUSION

Chapter Five – Findings & Conclusion

Summary

This report assesses how environmental, social, and governance (ESG) considerations influence the financial performance of UAE companies during 2019-2023. The research seeks to relate ESG scores to quantitative financial measures, including Return on Assets (ROA) and net profit margin, using samples of nine companies drawn from various industries and listed in public sectors.

The major conclusions are threefold: for the environmental aspect, it showed positive outcomes towards profit margin while it was negatively related to return on assets; for the governance aspect, it had a positive impact towards return on assets but negative towards the profit margin; and lastly, the social aspect did not significantly affect any of the financial performance. This portrays that adjusting the ESG dimension into a firm's operations is not straightforward since it depends on the performance measure under consideration.

The report also contributes to addressing the research gap by narrowing down the region under study to UAE-listed companies and current data trends, which is useful for businesses in the region intending to promote ESG practices without losing sight of financial goals. There are other limitations, such as sample size and issues related to generalization, which cannot be ignored. It has been recommended that the corporate sector articulate balanced ESG strategies aimed at optimizing financial return and achieving sustainability.

Findings

1. **Environmental Factors on Financial Performance**

   The Environmental score has a significant negative impact on ROA with p–value 0.002. However, the environmental score shows a significant positive impact on profit margin with a p-value of 0.004. The result shows a significant impact with mixed results based on the different financial metrics being used. Thus, reject H1 for ROA and accept H1 for profit margin.

2. **Social Factors on Financial Performance**

   The social score shows no significant impact on both the financial metrics (ROA, profit margin) as a measure of financial performance, with a p-value of> 0.05. there is no significant impact, thus failing to reject H0 for both ROA and profit margin.

3. **Governance Factor on Financial Performance**

   The governance score has a significant positive impact on ROA with a p-value of 0.005. However, the Governance score has a significant negative impact on the profit margin with a p-value of <0.001. thus, accepting H3 for ROA and rejecting H3 for profit margin.

Overall, the findings revealed mixed outcomes based on different financial metrics being used. The environmental and governance factors have an impact on financial performance in the opposite direction. Environmental factors impact ROA negatively, whereas governance factors positively influence ROA. While the environmental factor positively influences the profit margin, the governance factor significantly negates the Profit margin. The social shows no considerable influence on either of the financial metrics being used as a measure of financial performance.

Limitations

Certainly, this study acknowledges certain shortcomings. One of the most important of these shortcomings is that it may be difficult to generalize findings for the whole economy of the UAE. The primary reason is that there are very few publicly listed companies on the stock exchange, making it harder to be able to avail complete and consistent datasets for all relevant companies in the region. Equally, the scope of the study is limited by the number of the variables considered, which is, though sufficient, are not exhaustive in covering all aspects contributing to the relationship between practices in ESG and financial performance.

Future endeavors may fill this gap by increasing the sample size to include a great diversity of companies, such as perhaps extending the study to include non-listed companies and regional subsidiaries, to create a more representative picture of the UAE economic milieu. Future studies could also consider collecting new variables like industry-specific ESG indicators and macroeconomic factors, or even longitudinal data to provide depth and breadth to the analysis.

Future research can thus build upon this framework to derive a more comprehensive understanding of ESG impacts across a wide range of contexts.

Conclusion

This research examined how Environmental, Social, and Governance (ESG) indicators relate to the financial performance of companies listed on the UAE Stock Exchange in various industries from 2019 to 2023. Within ESG, while environmental and governance dimensions have considerable results on financial performance, these dimensions differ in return metrics. Environmental dimensions, for instance, have a positive impact on profit margins but an adverse impact on ROA, whilst governance dimensions positively affect ROA but negatively impact profit margins. Furthermore, it was noted that the social dimension did not have any substantial influence on either of the financial performance measures, and hence, there is a need to delve deeper into the dimension's role in corporate performance.

The paper's findings indicate that integration of ESG outcomes is a complicated issue as these factors have a different impact on the financial performance of businesses. Therefore, the ESG initiatives in the UAE can also be aimed at long-term financial stability, enhancing the business's environment. Nevertheless, this cannot be achieved without consideration of the industry, regulatory, and stakeholder perspectives involved in the implementation of ESG factors.

The study fills an important research gap as it examines the challenges companies face in relation to the development of their corporate strategies and the peculiarities of the current corporate governance in the UAE. It also will serve as a valuable tool for various segments of society, including policymakers, investors, and businesspeople. The results have their limitations, such as sample size and generalized implications; however, these results provide insight into industry development and research direction. There is an urge for companies to focus on all-around ESG measures that should not only help improve their financial performance but also comply with the sustainability agenda of the UAE and the global climate.

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