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THE IMPACT OF ESG ON CORPORATE'S FINANCIAL PERFORMANCE

Submitted by

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This is to certify that SAAKSHI DEDHIA of T.Y.B.A. Economics, Semester V (2022 –2023) has successfully completed the project on IMPACT OF ESG ON INDIAN CORPORATE'S FINANCIAL PERFORMANCE under the guidance of MEGHA PAI.

Declaration by the Student

I, SAAKSHI DEDHIA, student of MITHIBAI COLLEGE of T.Y.B.A. Economics, hereby declare that the project titled THE IMPACT OF ESG ON CORPORATE'S FINANCIAL PERFORMANCE is submitted by me for Semester V of the academic year 2022-2023. I further state that this work is original and not submitted anywhere else for any examination and wherever necessary, proper citation is given in the reference list.

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Abstract

Due to growing awareness of environmental stability and the socioeconomic development of nations, the need for responsible and sustainable investment techniques has considerably increased. ESG (Environmental, Social, and Governance) factors are taken into account in responsible investment strategies to improve risk management and produce sustainable returns for investors. The goal of this research is to investigate how ESG factors affect the profitability and enterprise value of Indian public limited firms using a variety of metrics such as profit after tax, return on asset, and enterprise value. The annual ESG data of 96 Indian firms based on market capitalization listed on the Sustainalytics database has been used. Regression analysis was used to test the impact of ESG elements on the financial performance of the firms. The study's conclusions show that good corporate ESG performance enhances financial performance as tested by market-based and accounting metrics. The conclusions have applications for businesses, investors, regulators, and decision-makers. The study emphasizes the necessity of implementing sustainability reporting, which includes disclosing ESG scores. This will significantly enhance ethical business practices and the long-term sustainability of the shareholders' wealth.

Keywords: ESG Investing, Sustainable Investing, Corporate Financial Performance

CHAPTER 1:

INTRODUCTION

Today, businesses are shifting from the short-term, narrow goal of maximizing profits to long-term sustainability goals that include environmental, social, and governance objectives (Chelawat & Trivedi, 2016). The reason for this is the rising understanding that ESG variables are a substantial source of risk to the company and can have a big impact on its financial returns. Understanding the business case for ESG and the shift in corporate focus to these non-financial measures have made this a very relevant topic for academics and professionals to conduct research on (Chelawat & Trivedi, 2016).

1.1 Investment in India

India is currently recognized as one of the most significant participants in the world economic landscape (*Investment in India*, 2022). By 2025, the country's GDP, which is expanding quickly, is anticipated to reach $5 trillion USD. (*Investment in India*, 2022) India's economy currently provides a growing and thriving environment for both domestic and foreign investments. India accounts for the largest youth population in the world, where around 600 Million people are below 25 years of age (Unesco, n.d.) which can offer potential investors a workforce that is highly skilled and has a good work ethic (*Investment in India,* 2022).

India's massive domestic consumption, driven by the private sector, has been crucial to the development of the nation. There are 400 million middle-class individuals in India, who are the country's biggest consumers.(*Investment in India*, 2022) The main causes of India's rising domestic consumption are the country's developing middle class and rising disposable incomes. By 2025, the private consumer market in India is anticipated to grow four times.(*Investment in India*, 2022) The current administration is also concentrating on farmers and rural areas because rural India is quickly becoming a market for all kinds of consumer goods.

India's investment growth has also been made possible by a number of government efforts, including the improvement of infrastructure, the easing of FDI regulations, and the development of India's financial system. The government has promoted an FDI policy that is beneficial to investors, with the majority of sectors accepting 100% FDI via the automatic method. To keep India a desirable and welcoming place for investors, the FDI policy is also revised frequently.

1.2 Sustainability and Sustainable Development

Sustainability is essentially the capacity to meet the demands of the present generation while preserving the ability of future generations to meet their own needs (Union Development, 1987).

Although sustainability as a concept is a fairly new thing, the movement in its entirety has origins in social justice, environmentalism, globalism, and other earlier movements with shady pasts. Many of these concepts had come together by the end of the 20th century in the push for "sustainable development." (University of Alberta, 2008)

The idea encompasses not only the environment, which is currently thought to be the most important pillar of sustainability, but also other elements like people and the economy. Both PEST (Political, Economic, Social, and Technological factors) Analysis and Environmental, Social and Government Analysis i.e ESG Analysis include this as a key component.

Fig 1.1: The Three Pillars of Sustainability

Source: Corporate Finance Institute, 2021

As per a Brundtland Report of 1987, Sustainable Development is defined as

> *"A Development that meets the needs of the present generation without compromising the ability of future generations to meet their own needs"*

The 2030 Agenda which was adopted by all UN Member States in 2015 for Sustainable Development, provides a common framework for prosperity and peace for both individuals and the environment now and in the long run (Nation., 2015). The 17 Sustainable Development Goals (SDGs) are at the core of it, and they are an immediate call to action by all countries, developed and emerging, in a global partnership (Nation., 2015). They recognize that eradicating poverty and other economic hardships must be combined with strategies to improve healthcare and education, reduce inequality at every sphere, and stimulate economic growth –all while addressing climate change and working to protect our water bodies and natural resources (Nation., 2015). The 17 SDGs were replaced by the 8 Millennium Development Goals in 2015 as they covered a wider and more integrated issues which were more important for the social development in a country. Every country had to implement and achieve these 17 goals from the period between 2016 to 2030. The slogan "Sabka Saath, Sabka Vikas" by our Prime Minister which means "Collective Effort, Inclusive Growth" was the pillar of the Indian Development Agenda. (Nation., 2015)

Fig 1.2: Sustainable Development Goals

Source: (United Nation, 2015)

1.3 Socially Responsible Investing (SRI)

Socially Responsible Investing (SRI) a technique that takes into account an investment's effect on social, ethical, and/or environmental change in addition to its financial returns. (Corporate Finance Institute, 2021b) Most frequently, it includes investing with a negative screen that would pick out businesses doing things the investor sees unacceptable. For instance, an SRI investing plan might not include businesses engaged in the sale of alcohol, cigarettes, gambling, or weapons. Additionally, nations having a history of violating human rights have been excluded from portfolios.

In the past, SRI has also prohibited businesses that were active in South Africa during the apartheid era, and more recently, those who conducted business with conflict minerals. (Hill, 2020)

This investing strategy need not always be centered on excluding negative players. Instead, it might proactively invest in businesses that support environmental or social justice principles. It could also entail financial support for businesses that offer services to the neighborhood. The most important distinction is that ESG investing provides advice on which firms to include in an overall portfolio approach whereas SRI factors lead to the filtering out of specific companies. A significant risk is that portfolio returns that are below market benchmarks could result from a strategy of merely omitting companies. Older studies that demonstrate the historically poor performance of these funds are frequently used as proof of the weak performance of all SRI and ESG funds, whether they are more sophisticated or divestment-oriented. (Hill, 2020)

1.4 Ethical Investing

Ethical Investing is a way of investing, which prioritizes the investor's moral, religious, and social ideals over financial gain. Many investors have started to demand that the companies they participate in are socially responsible due to the rise in doubtful and unethical investment arrangements. This implies showing respect for their staff, developing healthy products and services, and preventing from any form of unethical business activities. (Corporate Finance Institute, 2021)

Avoiding investments in businesses that make goods that go against the investor's social, moral, and religious ideals is one of the main goals of ethical investors. However, refraining from investing in a bad corporation does not prevent money from still going to that organization (Corporate Finance Institute, 2021). When an investor buys a stock, the money goes to the seller, who is an individual investor and not the corporation, and not to the buyer of the stock. The business only generates profits when it issues new shares, such as in an IPO (Initial Public Offering) (Corporate Finance Institute, 2021). Therefore, moral investors do not penalize bad enterprises.

Additionally, by refraining from doing business with a company, ethical investors are lowering the number of possible shareholders, which could drive down the price of the stock. This will only encourage unethical investors to purchase the stock at these lower prices. Although ethical investing is good for society, it must meet a number of requirements that are difficult to meet. (Corporate Finance Institute, 2021)

- Finding a profitable company concept will benefit the entire world. Solar power systems are a fantastic example of ethical investments. However, a company that finances solar panels but pollutes the environment during production will fail (Corporate Finance Institute, 2021a).
- The investor must be able to recognize a business opportunity that will have a good influence on the environment in order for there to be "additionality"—a strategy for the business to expand sustainably (Corporate Finance Institute, 2021a). In the stock market, it is challenging to accomplish such a goal.
- Not investing in immoral businesses doesn't mean they'll go away; in fact, they might continue to thrive because there will always be new investors looking for big profits. (Corporate Finance Institute, 2021)

1.5 What is Corporate Social Responsibility (CSR)?

The term "corporate social responsibility" (CSR) is a business strategy that involves taking part in initiatives that benefit society. CSR is about how businesses run their operations to have a net-positive effect on society (*Corporate Social Responsibility » IILS Blog*, 2016).

According to the World Business Council for Sustainable Development's publication Making Good Business Sense by Lord Holme and Richard Watts,

> *"Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large."*

Fig 1.3: Corporate Social Responsibility

Source: (*Corporate Social Responsibility » IILS Blog*, 2016)

Businesses have an important role in society, and their success has an impact on others. According to a Harvard Business Review report, CSR and profitability are strongly correlated. (*Corporate Social Responsibility » IILS Blog*, 2016)

Corporate social responsibility (CSR) makes sure businesses operate ethically. Considering their effects on society, the economy, and the environment as well as human rights The two categories of corporate social responsibility are as follows. The first involves businesses supporting deserving social causes with money and resources, such as giving to charities or volunteering company time (*Corporate Social Responsibility » IILS Blog*, 2016). This is the definition of corporate responsibility that many people think of. The creation of a concrete plan to produce goods or offer services that are beneficial to society is another sort of CSR, though. (*Corporate Social Responsibility » IILS Blog*, 2016) Utilizing secure materials throughout design and production, corporate environmental initiatives, and other aspects like job creation and economic growth are a few examples of these. (*Corporate Social Responsibility » IILS Blog*, 2016)

The businesses need to genuinely support philanthropic and social causes. The CSR initiatives can enhance their company's reputation, draw in more job applicants and clients, and boost employee engagement. It may serve as a source of chance, invention, and competitive benefits. Due to the fact that forward-thinking businesses are integrating sustainability into the core of their operations to generate value for both the business and society, CSR is becoming more mainstream. Sustainability is crucial for company success as well as for the welfare of people and the environment. (*Corporate Social Responsibility » IILS Blog*, 2016)

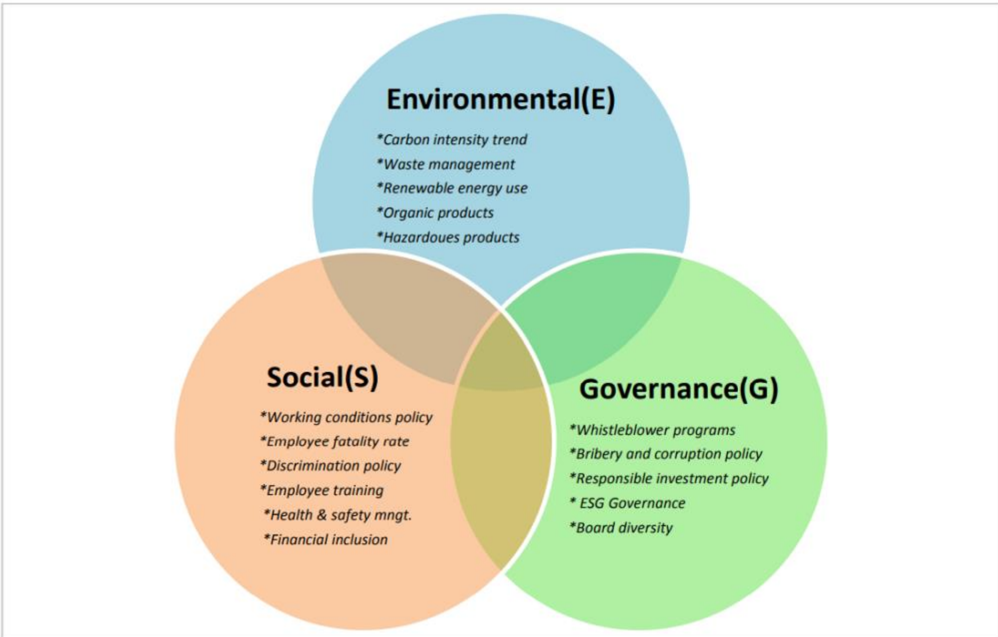
1.6 ESG Investing

Environmental, social, and governance investing, sometimes also known as "socially responsible investing," "impact investing," and "sustainable investing," (IISL, 2018) is the practice of prioritizing the best ESG aspects or outcomes. ESG investing, which involves making investments while taking into consideration the economy, environment, and welfare of people, is commonly referred to as a means of investing "sustainably and responsibly". ESG-based investments' core principle is to identify and quantify the intangible assets that environmentally and socially responsible companies with good governance processes have (Mishika, 2022). These companies are thought to have better ESG risk management practices, which benefits investors by generating value through long-term sustainable business models. (IISL, 2018)

The ESG-based investment concept has a long history, with its origins in the 1960s and 1970s in the United States and Europe. In Europe, the first SRI fund was introduced in Sweden in the 1960s, although social and political developments in the US spurred the introduction of SRI in the 1970s. As of 2016, there were assets being managed professionally with an SRI theme valued $22.89 trillion worldwide. This reflects a respectable increase since 2014 of 11.9% CAGR. (IISL, 2018)

Organizations must understand and accept the change in the investing landscape. The term "investor" is no longer restricted to a small number of people. Instead, investing is becoming more widely recognized as a way for people to use their money as a kind of political expression, drawing investors from all over the world. Due to the growing introduction of more progressive and holistic ESG ideals into the investment world, the variety of considerations investors take into account when making decisions has expanded significantly (ADEC, 2022).

Fig 1.4: Broad ESG Metrics



Source: (IISL, 2018)

Concerns like COVID-19 and climate change have emphasized the vulnerability of businesses as usual strategies while also highlighting the significance of organizational resilience. In order to support future generations, shareholders and stakeholders anticipate a shift toward company activity that is more environmentally, socially, and economically sustainable. By incorporating an ever-wider range of measurements into their daily operations and long-term objectives, organizations must strengthen their ability to adapt (ADEC, 2022). Organizations can position themselves for success by selecting ESG benchmarks that are important to them and setting realistic goals against these (ADEC, 2022)

1.7 What is Impact Investing?

In order to achieve both high investment returns and beneficial environmental or social outcomes, develop strategies in impact investing. (Rodeck & Schmidt, 2021)

David Spika, president and CIO at GuideStone Capital Management says,

> *"Impact investing provides a way for investors to be more proactive with their investment dollars and partner together to make purposeful investments that can contribute to affecting real change across the globe"*

It's crucial to understand that making an impact investment is just not giving to charity. Impact investors constantly strive to make a healthy profit and even outperform the market (Rodeck & Schmidt, 2021). They simply have additional objectives that go beyond seeking the highest possible returns on investment. (Rodeck & Schmidt, 2021)

Imagine you had the option to put money into a solar panel startup or a major oil firm. Using the conventional investment method, you would only take into account the option that would provide the highest financial return. Along with their prospective earnings, impact investors would also think about how both enterprises might affect the environment. (Rodeck & Schmidt, 2021)

The solar panel manufacturer would be chosen by an impact investor, especially if the estimated return is comparable. Even if the oil firm gave a higher return on investment, an impact investor might still choose the solar panel company because it has a better environmental impact than oil. (Rodeck & Schmidt, 2021)

CHAPTER 2:

REVIEW OF LITERATURE

2.1 <u>ESG and Corporate Financial Performance: A Panel Study of Indian Companies</u>

This paper by Karishma K Dalal and Nimit Thaker makes a substantial literary contribution to the field of evaluating ESG in the Indian context. This paper examines 65 Indian Companies listed on NSE 100 ESG Index from 2015 to 2017 (Dalal & Thaker, 2019). The paper makes it abundantly evident that businesses with higher ESG scores do perform better financially. Compared to previous studies, this one employs a higher standard of methodological rigor; the financial performance of the corporation is assessed not only in terms of accounting metrics, which are seen as a short-term performance report but also in terms of market metrics, which are seen as a gauge of long-term firm performance. (Dalal & Thaker, 2019) The analysis is more thorough when financial performance is evaluated using a variety of metrics. This adds significantly to the contribution already available.

The findings of this paper have real-world applications for investors, decision-makers, Indian Enterprises, and most importantly investors. The findings clearly show that investors choose businesses with low environmental risk, greater social acceptance, and transparency in Government policies. Companies with reduced ESG risks are more likely to provide a sustainable financial performance and, as a result, can draw investors' attention for a longer period of time. Corporations will have to support sustainable business models and good governance procedures in order to enjoy the investor's preference. The study also emphasizes the requirement for sustainability reporting, which includes ESG Score disclosure. The scope of required disclosures, which mostly concentrate on the financial elements of the corporation, has to be expanded by regulators to also cover the social and environmental effects of the company's operations. This would contribute to the improvement of ethical business practices and the financial sustainability of the shareholders. (Dalal & Thaker, 2019)

2.2 <u>Environmental, Social, and Governance (ESG) Investing: A Balanced Analysis of the Theory and Practice of a Sustainable Portfolio</u> (Hill, 2020)

This Book tries to define ESG goals and means, challenges in defining, measuring, and reporting firm ESG performance, and various, frequently contradictory analyses of the relative performance of sustainable investments. In addition, the author thinks that ESG investments are here to stay and will probably continue to expand, particularly as the Millennial generation and Gen Z become a more significant force in the investing market (Hill, 2020). People are increasingly seen as concerned citizens who value clean air, clean water, and good governance principles (Hill, 2020), rather than just as income-maximizing shareholders or profit-maximizing company managers. This book has two main goals: first, it provides a comprehensive review of the conflicting theories and empirical data supporting ESG investing, and second, it gives a summary of some of the most attractive ESG investment vehicles and modalities. The emphasis of the book is on portfolio construction and ESG factors in investment decisions (Hill, 2020).

However, there are a number of other ways for investors to put their ESG sensitivity into practice. This leads to discussions on issues like shareholder activism, impact and purpose investment, family foundations, and faith-based investing. (Hill, 2020)

This book covers various concepts related to the broad term of ESG such as Sustainable and Responsible Investment (SRI), impact investing, mission investing, etc.

2.3 **ESG and financial performance: aggregated evidence from more than 2000 empirical studies** (Friede et al., 2015)

All available primary and secondary data from earlier academic review studies are extracted by the authors of this paper for the purpose of review. By doing this, the study synthesizes the results of nearly 2200 distinct studies. As a result, this study provides the most thorough summary of academic research on the subject and enables generalizations. The findings demonstrate how objectively sound the business case for ESG investing is. Nearly 90% of research discover a positive relationship between ESG and Corporate Financial Performance (Friede et al., 2015). More significantly, the vast majority of studies present optimistic results.

The authors emphasize that the positive ESG influence on Corporate Financial Performance appears consistent over the period (Friede et al., 2015).

2.4 <u>**Values at Work: Sustainable Investing and ESG Reporting**</u> (Esty & Cort, 2020)

The field of sustainable investing is one that is expanding quickly. Companies are under pressure to become more sustainable as a result of investors' growing interest in environmental, social, and governance metrics and reporting. These issues include climate change, air and water pollution, racial justice, workplace diversity, economic inequality, privacy, corporate integrity, and good governance. (Esty & Cort, 2020)

Investors from all kinds of investment backgrounds from equity investments to fixed income securities, private equities, or impact investing want to understand which companies will be marketplace leaders in a corporate future that are redefined by sustainability. As a result, there is a rapid global change in investment strategies, risk models, financial instruments, applications, data, measurements, standards, and laws. In an attempt to better comprehend the current state and movement of this dynamic and changing environment, this edited book discusses the most recent developments, tools, and ideas. It also serves as a helpful resource for the growing community of investors, finance professionals, companies, and academics interested in learning more about sustainable investing and ESG disclosure (Esty & Cort, 2020). It features the work of authors from prominent businesses and academic institutions on a variety of important subjects, including financial disclosures, portfolio evaluation, the creation of ESG indicators, and legislation and regulation. (Esty & Cort, 2020) The book will provide readers to be better equipped to recognize and deal with the obstacles that prevent mainstream funding from going to more sustainable businesses, investments, and initiatives.

2.5 <u>**Sustainability Practices and Corporate Financial Performance: A Study Based on the Top Global Corporations**</u> (Ameer & Othman, 2012)

This research paper aims to test the hypothesis that businesses with better sustainability practices outperform those that don't in terms of growth and financial performance. In order to establish four indices that indicate the dedication of multinational firms to their ethical, environmental, community, and diversity duties, (Ameer & Othman, 2012) the authors looked at sustainability reports of the world's most sustainable corporations in the first part of this study. The research demonstrates that eco-centric issues are given more weight by global sustainable enterprises than by ethnocentric issues. (Ameer & Othman, 2012)

Nevertheless, the statistical findings demonstrate that, in some activity areas, businesses that prioritize sustainable practices outperform those that don't in terms of return on assets, profit before taxes, and cash flow from operations. (Ameer & Othman, 2012) Additionally, our results demonstrate that the superior financial performance of sustainable businesses has grown and been maintained over the years of 2006-2008, 2006-2009, and 2006-2010, respectively (Ameer & Othman, 2012). The authors fount that over the years 2006 to 2010, Return on Asset, Profit before Tax, and CFO all grew steadily. Results show that there is a relationship between business sustainability practices and corporate financial performance, despite sample size and time period limitations (Ameer & Othman, 2012). Even with disputes regarding the value of allocating resources to help a company become "more responsible" in the eyes of stockholders, the results show that these techniques have been demonstrated to be in the corporation's best interests and, ultimately, in the interests of shareholders, and the legal owners (Ameer & Othman, 2012).

The evaluation of a company's social impact is a difficult process; in this study, the authors have mostly evaluated philanthropic activities and a few diversity-related issues (Ameer & Othman, 2012). These practices make up a large portion of CSR operations nowadays, and it is challenging to determine what an ideal and optimal corporate social commitment is from an ethnocentric perspective. In order to assess the effects of sustainable practices for for-profit firms, the authors therefore suggest that future research construct "alternative" performance measures based on the many community views. Lastly, while concluding the research paper suggests that future research should attempt to determine the influence of external and internal factors on the organizations' growth towards sustainable development in emerging economies as this is a significant limitation of this research paper since the authors only focused on the top 100 global sustainable companies, which are primarily located in developed economies. (Ameer & Othman, 2012)

2.6 **<u>The business value of ESG performance: the Indian context</u>** (Chelawat & Trivedi, 2016)

This Research paper attempts to solve a critical gap in the literature on sustainable investments in India, which is one of the biggest emerging market economies in the world. With objectivity and analytical rigor, it seeks to analyze the connection between corporate ESG performance and corporate financial performance in order to present solid data on the influence of strong ESG performance on businesses' financial performance. This research paper will aid businesses in developing nations, particularly India, in developing their ESG practices and assisting investors in making investment decisions. (Chelawat & Trivedi, 2016)

The study included a sample of two groups of businesses that were examined for the years 2008 to 2013. The businesses in the first group had good ESG performance, while the businesses in the second group did not appear on the index since they had poor ESG performance. The NSE CNX Nifty 100 companies served as the study's sample. It demonstrates clearly that strong ESG performance improves financial performance in India, which can be quantified by accounting-based metrics like ROCE and market capitalization-based metrics like Tobin Q Ratio. Various statistical tools such as correlation analysis, random effects panel regression model, variance inflation factors, etc. (Chelawat & Trivedi, 2016)

Businesses today are shifting their focus from the short-term, narrow goal of maximizing profits to long-term sustainability goals that include environmental, social, and corporate governance objectives (Chelawat & Trivedi, 2016). The reason for this is the rising understanding that ESG variables are a substantial source of risk for the company and can have an impact on their financial results. Improved ESG performance has been linked to decreased risk and better financial performance, according to academic study, but outcomes appeared to differ greatly by country. Using panel regression models, it experimentally investigates the effects of companies' environmental, social, and corporate governance performance on their financial performance in India. The study's conclusions show that strong company ESG performance improves financial performance (Chelawat & Trivedi, 2016). The study's conclusions have significant ramifications for regulators, lawmakers, company management, and investors. (Chelawat & Trivedi, 2016)

2.7 <u>The Impact of Sustainability Practices on Corporate Financial Performance: Literature Trends and Future Research Potential</u> (Alshehhi et al., 2018)

In this literature, the focus has shifted from examining the effects of individual sustainability elements on company financial performance to a broader examination of the whole sustainability impact, which has been narrowed to an exclusively environmental-social combination, as in CSR. The issue with this strategy is that it might easily overlook the true significance of environmental sustainability because the environmental component of CSR is so minimal. In contrast to either of the single economic or social dimensions of sustainability, a fair number of publications have continued to appear in the previous six years on the single dimension of environmental sustainability, which appears to make up for this. (Alshehhi et al., 2018)

When analyzing the effect of sustainability practices on business financial performance, this literature keeps introducing new financial metrics, particularly market-based ones. Although certain accounting financial measures still predominate the range of measurements in the literature, there isn't yet a consensus among researchers on the ideal set of financial measures. Accounting metrics are complemented by market-based financial measures because they provide deeper understanding of corporate performance that takes future performance expectations into consideration. Beginning in 2012, the number of distinct financial measures has dramatically increased due in part to market-based financial measurements. During the same time period, there was also a sharp increase in the number of articles discussing the effect of sustainability on business financial performance (Alshehhi et al., 2018). While those trends were developing, a new, intriguing tendency emerged when the literature began to move in the direction of combining a social-environmental combination with a comprehensive sustainability approach to business performance. The issue with this combined strategy is that it downplays the environmental sustainability while ignoring the economic sustainability. (Alshehhi et al., 2018)

CHAPTER 3:

RESULTS AND DISCUSSIONS

3.1 Objectives of the study

a) To examine the relationship between Corporate's ESG Performance and Corporate's Financial Performance.

b) To understand how adopting ESG measures can affect the profitability of the firm.

c) To empirically investigate the influence of ESG on the performance of listed Indian companies in terms of the company value.

3.2 Hypothesis

3.2.1 $\boldsymbol{H_0}$: There is no statistically significant relationship between ESG factors and value of Indian public limited companies.

v/s

$\boldsymbol{H_1}$: There is a statistically significant positive relationship between ESG factors and value of Indian companies.

3.2.2 $\boldsymbol{H_0}$: There is no statistically significant relationship between ESG factors and profitability of Indian companies.

v/s

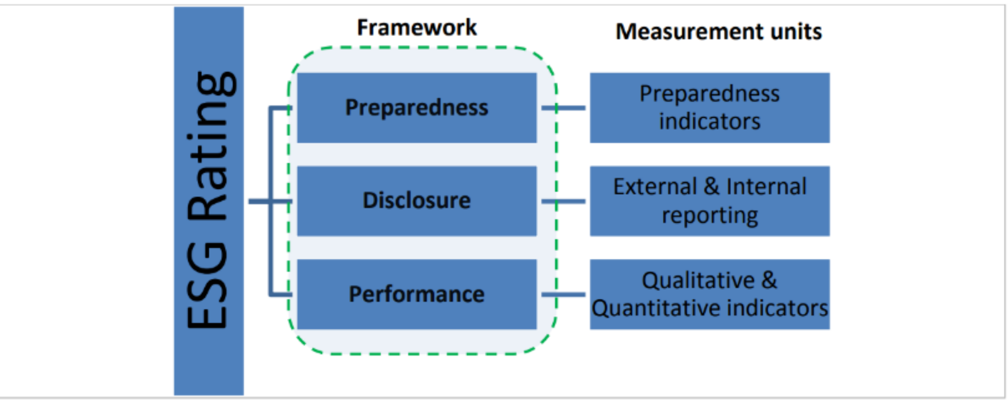
$\boldsymbol{H_1}$ **:** There is a statistically significant positive relationship between ESG factors and profitability of Indian companies.

3.3 Research Methodology

This study tries to understand the impact of ESG on Indian Corporate's financial performance using secondary sources of data using both quantitative and qualitative approach. ESG scores of 96 Indian Public listed companies based on market capitalization are taken into account from the Sustainalytics Database. The ESG scores have been arranged in the descending order of their scores. Microsoft Excel was used to find the results.

The various methods used for analysing the data are Descriptive Statistics, Pearson's Correlation Coefficient and Regression Analysis

Fig 3.3.1: Sustainalytics ESG Rating Framework



Source: (IISL, 2018)

Fig 3.3.2: Sustainalytics ESG Research Process

Source: (IISL, 2018)

3.4 Analysis of the study

3.4.1 Descriptive Statistics

The table summarizes the descriptive statistics i.e mean, median, standard deviation, etc. of the dependent and independent variables taken into the study. To study the financial performance of the companies, Return on Asset (ROA) and Profit After Tax (PAT) have been taken into consideration.

Table 1: Descriptive Statistics				
	ESG	**PAT**	**ROA**	**EV**
Mean	26.95520833	7860.998333	9.224375	322063.0084
Standard Error	0.907013208	1218.46608	0.805570298	61285.27728
Median	26.7	2831.255	8.435	120849.34
Standard Deviation	8.886878201	11938.48066	7.892944726	600470.6323
Sample Variance	78.97660417	142527320.5	62.29857645	3.60565E+11
Kurtosis	-0.274797115	6.790430255	0.713260272	29.64468645
Skewness	0.356312026	2.402510639	0.317872191	4.898651696
Minimum	11.6	-12841.85	-14.37	51579.76
Maximum	50.2	64301.73	28.81	4631508.65

Where,
ROA: Return on Asset
PAT: Profit After Tax
EV: Enterprise Value

3.4.2 Correlation Results

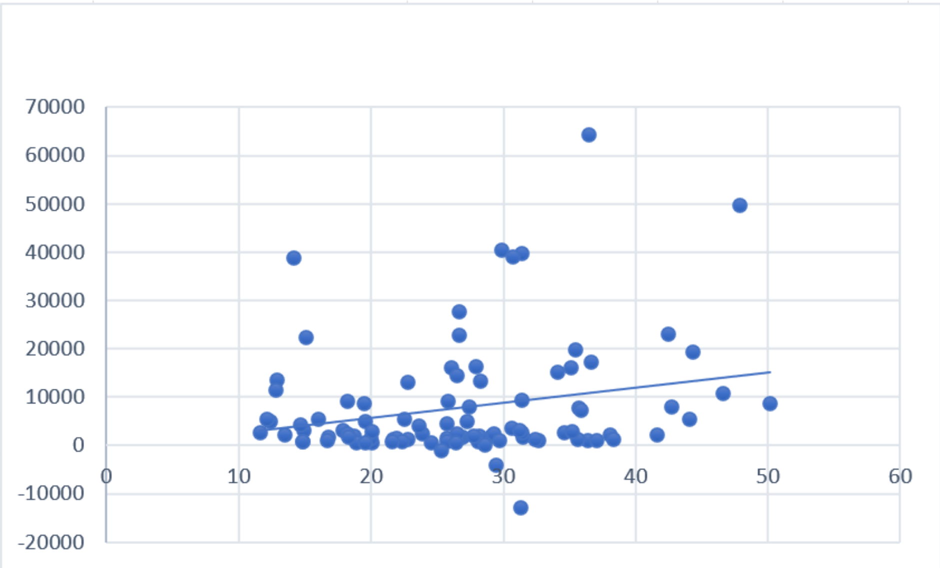
Table 2: Pearson's Correlation Matrix				
	ESG	**PAT**	**ROA**	**EV**
ESG	1			

PAT	0.232805	1		
ROA	-0.20769	-0.20769	1	
EV	0.091848	0.644542	-0.20795	1

Where,
ROA: Return on Asset
PAT: Profit After Tax
EV: Enterprise Value

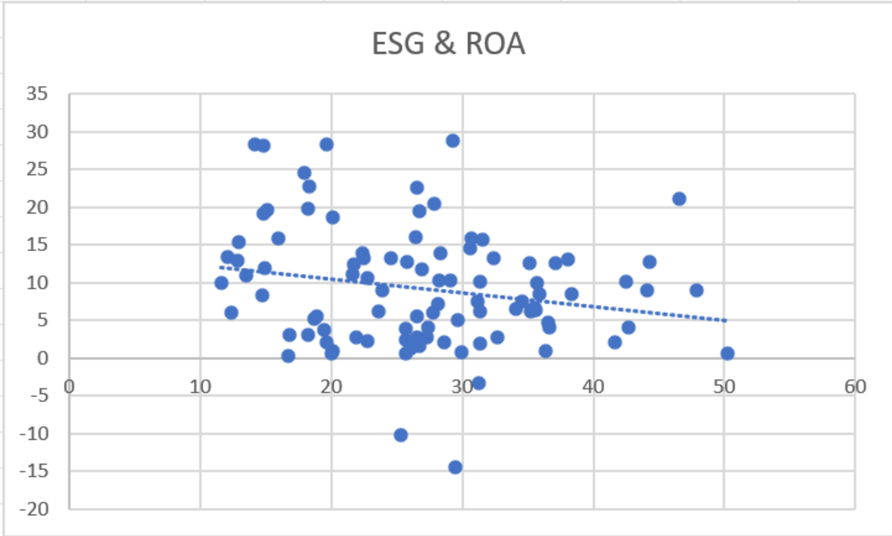
The above table shows the correlation results of dependent and independent variables. The results indicate that ESG scores have significant positive relationship between Profit After Tax (PAT), whereas ESG and Return on Asse (ROA) show a significant negative relationship and ESG when compared with Enterprise Value shows a positive relationship. The scatter plots for these have been drawn below.

Fig 3.4.2.1: Scatter Plot for ESG and PAT



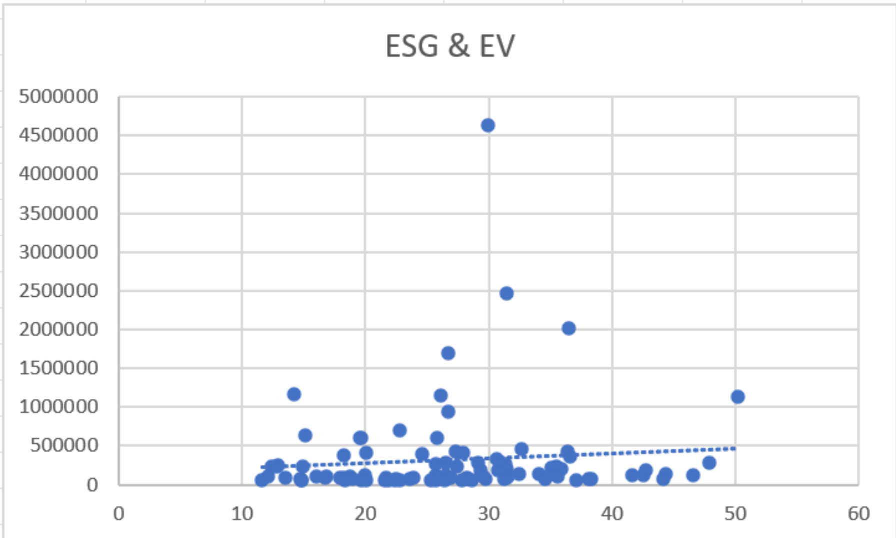
Source: Primary

Fig 3.4.2.2 Scatter Plot for ESG and ROA



Source: Primary

Fig 3.4.2.3 Scatter Plot for ESG and Enterprise Value



Source: Primary

3.4.3 Hypothesis Testing

3.4.3.1 $\boldsymbol{H_0}$ **:** There is no statistically significant relationship between ESG factors and value of Indian public limited companies.

v/s

H_1 : There is a statistically significant positive relationship between ESG factors and value of Indian companies.

Table 3: Regression Analysis of EV on ESG Score

Regression Statistics	
Multiple R	0.091847945
R Square	0.008436045
Adjusted R Square	-0.002112508
Standard Error	601104.5471
Observations	96

ANOVA					
	df	***SS***	***MS***	***F***	***Significance F***
Regression	1	2.88966E+11	2.88966E+11	0.799734832	0.373456714
Residual	94	3.39647E+13	3.61327E+11		
Total	95	3.42537E+13			

	Intercept	**X Variable 1**
Coefficients	154778.9019	1.35934E-06
Standard Error	196863.8699	1.52004E-06
t-stat	0.786222998	0.894278945
p-value	0.433714387	0.373456714
Lower 95%	-236098.9266	-7572.879549
Upper 95%	545656.7304	19984.88576

Source: Primary

Since the t-stat value is less than the critical value and P-value is more than the Level of Significance. Thus,

We fail to reject the null hypothesis.

This means that there is not enough evidence to accept the alternative hypothesis which means that enterprise value does not affect the ESG factors in that company.

3.4.3.2 H_0 : There is no statistically significant relationship between ESG factors and profitability of Indian companies.

Vs

H_1 **:** There is a statistically significant positive relationship between ESG factors and profitability of Indian companies.

Table 4: Regression Analysis of PAT on ESG score

Regression Statistics	
Multiple R	0.232805132
R Square	0.05419823
Adjusted R Square	0.044136509
Standard Error	11672.04619
Observations	96

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	733849201.8	733849201.8	5.386576489	0.022454277
Residual	94	12806246250	136236662.2		
Total	95	13540095452			

	Intercept	**X Variable 1**
Coefficients	-569.1472603	0.000173298
Standard Error	3822.6365	7.46683E-05

t-stat	-0.148888669	2.320899931
p-value	0.881960436	0.022454277
Lower 95%	-8159.08164	45.19273039
Upper 95%	7020.78712	580.3001606

Source: Primary

Since the t-stat value is more than the critical value and P-value is less than the Level of Significance. Thus,

We Reject the null hypothesis.

This means that there is enough evidence to accept the alternative hypothesis which means that profitability of a firm does affect the ESG factors in that company. So, larger profits lead to higher compliance with the requirements of ESG.

CHAPTER 4:

FINDINGS OF THE STUDY

4.1 To examine the relationship between Corporate's ESG Performance and Corporate's Financial Performance

The results clearly indicates that ESG scores do affect the corporate's financial performance and good profitability of the firm also leads to higher compliance with the ESG requirements. So, ESG performance of a firm has significant positive relationship with the Financial Performance of the firm. It means that investors do check for company's environmental, social and governmental impacts for long term investment because firms who have compliance with all these areas tend to provide better financial returns in the longer run.

Six major findings are:

- ✓ With a longer time horizon, the ESG-related improvement in financial performance becomes more noticeable. (Whelan et al., 2021)
- ✓ ESG momentum may encourage improvers to outperform leaders and ESG integration as a strategy appears to perform much better than negative screening approaches. (Whelan et al., 2021)
- ✓ Particularly during times of social or economic crises, ESG investing tends to offer downside protection. (Whelan et al., 2021)
- ✓ Due to elements like enhanced risk management and increased innovation, sustainability programs at firms tend to boost financial performance. (Whelan et al., 2021)
- ✓ According to studies, managing for a future with minimal carbon emissions enhances financial performance. (Whelan et al., 2021)
- ✓ Financial performance is not driven by ESG disclosure alone. (Whelan et al., 2021)

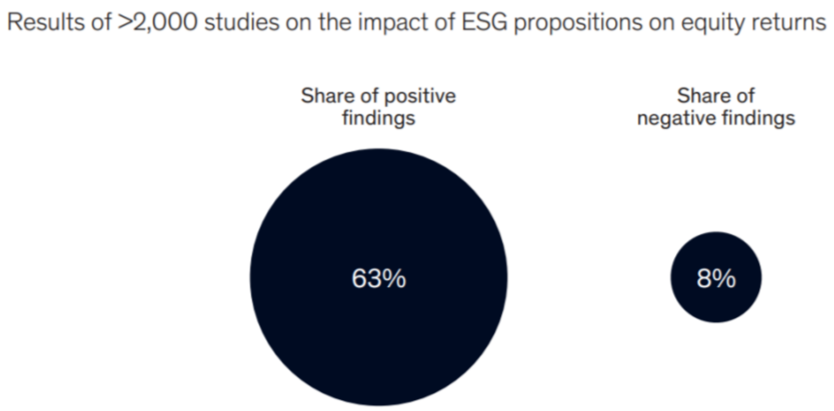
4.2 To understand how adopting ESG measures can affect the profitability of the firms.

Proactively tackling ESG issues has advantages beyond garnering the support of institutional shareholders and developing a positive public relations narrative. An effective ESG program may improve corporate brands, make it easier to access large financing sources, and promote sustainable long-term growth that benefits both firms and investors. (Henisz et al., 2019) Here is how:

- ✓ Better ESG initiatives can boost stock liquidity
- ✓ ESG projects can increase competitive advantage.
- ✓ Taking the initiative on ESG concerns can deter campaigners.
- ✓ ESG investors stay for long term and are ‘stickier’
- ✓ The finest talent tends to be attracted to and retained by businesses that uphold strong ESG ideals. (Henisz et al., 2019)

The fact that money will keep flowing into companies with successful ESG programs and practices since many investment firms now integrate ESG analyses in their overall portfolio risk assessments. (Henisz et al., 2019)

Fig 4.1 Impact of ESG Propositions on equity returns



Source: (Henisz et al., 2019)

4.3 To empirically investigate the influence of ESG on the performance of listed Indian companies in terms of the value of the firm

The study shows that value of the firm has significantly very low relationship with ESG which says that firms value may or may not impact firm’s ESG performance. Results show that the relationship between the broad and specific ESG factors and company value is not significant.

CHAPTER 5:

CONCLUSION

This study makes a substantial contribution to the body of knowledge about the assessment process of ESG in the Indian setting. The paper makes it abundantly evident that firms with higher ESG scores do perform better in terms of financial performance. The analysis is more thorough when financial performance of the firm is evaluated using a variety of metrics. This adds significantly to the body of knowledge already available. The findings have applications for policy makers, investors, and regulators as well as Indian firms. The analysis is more thorough when financial performance is evaluated using a variety of metrics. This adds significantly to the body of knowledge already available. The findings have applications for financiers, authorities, decision-makers, and Indian businesses. The findings unmistakably show that investors choose businesses with lower carbon impact, larger social acceptance, and open governance practices. Companies with reduced ESG risks are more likely to provide a sustainable financial performance and, as a result, can draw investors for a longer period of time (Dalal & Thaker, 2019). The study also explained that ESG does not impact the value of the firm to a great extent.

Corporates will have to support sustainable business models and good governance procedures in order to enjoy the investor's preference (Dalal & Thaker, 2019). The study also emphasizes the requirement for sustainability reporting, which includes ESG Score disclosure. The scope of required disclosures, which mostly concentrate on the financial elements of the corporation, has to be expanded by regulators to also cover the social and environmental effects of the company's operations.

This would contribute to the improvement of ethical corporate conduct and the long-term sustainability of the wealth of the shareholders.

5.1 Limitations

One of the major limitations of the study include that the ESG scores taken from Sustainalytics were between 0 to 50 which when compared with PAT and EV numbers affected my correlation results. Time constraint was another major issue while doing the research work as it was limited to do within time frame of 3 months which restricted from exploring more on this topic. ESG scores might not accurately represent a company's actual ESG practices. The chance that other factors, such as the business environment or competition, could also have an impact on the financial performance of the corporation (Dalal & Thaker, 2019).

5.2 Scope for future study

The issues mentioned in the limitations can be taken up as a future study by researchers. Future research could also look upon other factors affecting corporate financial performance using other variables such as ROCE, ROE, etc

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APPENDIX

Company Name	ESG SCORES
Bank of Baroda	50.2
O N G C	47.9
Hindustan Zinc	46.6
Vedanta	44.3
Hindustan Aeronautics	44.1
Grasim Industries	42.7
Coal India	42.5
Tata Power Co.	41.6
Varun Beverages	38.3
SRF	38.1
Berger Paints	37.1
NTPC	36.6
Reliance Industries LTD	36.5
Adani Enterprise	36.4
UltraTech Cement	35.9
Sun Pharma Industries	35.7
Siemens	35.6
I O C L	35.5
B P C L	35.2
JSW Steel	35.1
Bharat Electron	34.6
Hindalco Industries	34.1
Adani Transmission	32.7
Pidilite Industries	32.4
Dabur India	31.5

HDFC Bank	31.4
Adani Power	31.4
Cipla	31.4
Tata Motors	31.3
Dr Reddy's Labs	31.2
Tata Steel	30.7
Asian Paints	30.6
St Bk of India	29.9
Tata Consumer	29.7
Interglobe Aviat	29.5
Nestle India	29.3
Avenue Super.	29.1
FSN E-Commerce	28.6
GAIL (India)	28.3
Shree Cement	28.2
Apollo Hospitals	28.1
ITC	27.9
JSW Energy	27.8
M & M	27.4
Bajaj Finserv	27.3
Godrej Consumer	26.9
ICICI Bank	26.7
H D F C	26.7
Britannia Inds.	26.7
Power Grid Corporation	26.5
Marico	26.5
Cholaman.Inv.&Fn	26.5
Astral	26.4

Axis Bank	26.1
Hind. Unilever	25.8
Maruti Suzuki	25.7
SBI Life Insurance	25.7
Samvardh. Mothe.	25.7
Zomato Ltd	25.3
Adani Total Gas	24.6
Ambuja Cements	23.9
UPL	23.6
Kotak Mahindra Bank	22.8
United Spirits	22.8
Indus Towers	22.5
Schaeffler India	22.4
ICICI Lombard	21.9
Havells India	21.7
Tube Investments	21.6
Adani Green	20.1
Info Edg.(India)	20.1
HDFC Life Insurance	20
Bharti Airtel	19.6
Tata Elxsi	19.6
Bajaj Finance	19.5
A B B	18.9
SBI Cards	18.7
Mindtree	18.3
Larsen & Toubro	18.2
L & T Infotech	18.2
Divi's Lab.	17.9

DLF	16.8
ICICI Prudential Life	16.7
Bajaj Auto	16
Infosys	15.1
Titan Company	14.9
I R C T C	14.8
Page Industries	14.8
Bajaj Holdings	14.7
TCS	14.2
Eicher Motors	13.5
HCL Technologies	12.9
Wipro	12.8
Adani Ports	12.4
Tech Mahindra	12.1
Hero Motocorp	11.6