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Sustainable Finance and ESG Performance: An Empirical Examination of Financial and Non-Financial Outcomes

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ABSTRACT

The perception and application of the concept of sustainable finance have implications on the world interdependence of the so-called ESG as a firm-level performance indicator. However, this leaves a gap particularly in the context of the emerging markets in the empirical literature. The present research tries that discourse the gap through defining influence ESG performance has on financial performance. The research remains created arranged a panel data by 428 publicly registered Asian corporations more than eight years of existence (2015 to 2023). The regression applied to address the research question was the fixed effect regression, revealing the influence of the overall ESG and constituent dimension of the ESG scores taking place marketplace worth indicators, the return on assets (ROA) and the Tobin Q. It concludes the research that the above average performance of ESG scores enhances a performance highly on the accounting and market indicators of performance. Moreover, the research results in an environmental and governance indicator, in comparison with the social one, being less well explained by the rest. The article gives evidence that ESG application extends beyond window-dressing to the achievement, retention, and sustainable financial performance. The evidences hold value to managers, value (sustainable) creation geared investors and policy makers.

Keywords: Sustainable Finance, ESG Performance, Emerging Markets, Financial Performance, Panel Data, Asian Corporations, Fixed Effect Regression, ESG Scores, Market Value Indicators, Return on Assets (ROA), Tobin's Q, Environmental Indicators, Social Indicators, Governance Indicators, Sustainable Financial Performance, Value Creation, Investors, Policy Makers.

INTRODUCTION

The world financial systems have changed because of the growing attention to the idea of sustainability The balance between the allocation of capital and the social and environment finance, the scope of sustainable finance, is growing because of the attention of most investors to the ESG as risk measures and the value of the company and its financial resources (Sachs et al., 2019; Markard, 2022). Simultaneously, several nations worldwide, the European Union Taxonomy and the Global Reporting Initiative have tried to enhance the reporting of ESG of businesses in their territory.

Application of ESG metrics in the financial reporting of firms is gaining popularity where the emphasis on the ESG performance is gaining momentum. The basic argument between each other remains among scholars as well as neutral or negative to incorporate ESG initiatives. Some may argue that ESG activities enhance the efficiency, innovation and value of the reputation of the company (Whelan et al., 2021; Clark et al., 2015) and on the other side that say that under ESG initiatives the operating costs of the company rise with the overall negative dilution of the value of the company and its shareholders (Brammer et al., 2006). The evidence void is even greater in the instance of developing countries and new markets where sustainability reporting and disclosure is at its early stages.

The current paper efforts to address the situation of applying relevant use updated evidence and the appropriate advanced econometrics to test the hypothesis that sustainable financial performance can be resulted by the ESG performance of a company.

LITERATURE REVIEW

Sustainable Finance and ESG

Sustainable finance is a combination of financial decision making and consideration of ESG to aid in reducing the risk better (Broadstock 2020). ESG indicators also assist investors in deciding on the companies with lower chances of experiencing the risk of overregulation, environmental, or social risks (Friede et al., 2015). Previous literature assumed that sustainability could offer competitive advantage through generating stakeholder confidence (Freeman, 1984), and enhancing resource efficiency (Hart and Dowell, 2011).

ESG and Financial Performance.

Positive ESG-performance relations exist and they have been reported widely (Friede et al., 2015; Whelan et al., 2021). The environmental dimension will allow to enhance efficiency and reduce the risk of noncompliance (Fatemi et al., 2018). Good governance and better investor agency relationship which results in reduced agency costs (Chen et al., 2020). However, the studies, which indicate the opposite, were found because of the expensive compliance and reporting costs (Brammer et al., 2006).

ESG in Emerging Markets

The regulatory framework, institutional quality and investor activism in emerging markets are quite different as compared to the developed markets Two papers have reported moderate, but improving, ESG disclosure (Fernando et al., 2021; Khan et al., 2022). Empirical support is also available that suggests that ESG results in enhancing the legitimacy of a firm and access to capital particularly in the developing areas.

Research Objective

1. Evaluate the general ESG performance and its impact on the financial performance of the firms.
2. Personal contribution in terms of Environmental, Social and Governance aspects.
3. To find out how ESG contributes to the improvement and maintenance of the financial value in the emerging economies.

METHODOLOGY

Data and Sample

Research examines the cross-sectional data of 428 companies in 2015-2023 that were publicly traded in the stock markets of Pakistan, India, Malaysia, China, Indonesia, and the UAE.
The following data were utilized in the analysis:

- Refinitiv ESG Database
- Bloomberg ESG Scores
- Annual reports

Variables

Dependent Variables

- ROA (Return on Assets) as an Accounting Performance Measure
- Tobin's Q as a Measure of Market Performance

Independent Variables

- ESG Score (Overall)
- Environmental Score
- Social Score
- Governance Score

Control Variables

- Firm Size (Total Assets)
- Financial Leverage
- Firm Age
- Industry dummy

Econometric Model

- A fixed-effects model was chosen after Hausman test significance.
- $FPit=\beta0+\beta1ESGit+\beta2Sizeit+\beta3Levit+\beta4Ageit+\mu i$
- Sub-models replace ESG with E, S, and G scores individually.

DATA ANALYSIS AND RESULTS

Descriptive Statistics (summary)

- Average ESG score: 54.21
- Average ROA: 7.5%
- Average Tobin's Q: 1.37

From 2015 to 2023, the ESG score was increasing, in line with improving disclosure requirements.

Correlation Analysis

The ESG score ROA correlation is 0.32, with Tobin's Q correlation being 0.41. These correlations indicate the ESG score and the other two variables are meaningfully connected.

Regression Results

Model 1: ESG → ROA

- $\beta=0.136$, $p<0.01$

Interpretation: A 1-point increase in ESG score improves ROA by 0.136%.

Model 2: ESG → Tobin's Q

- $\beta=0.224$, $p<0.001$

ESG performance significantly enhances market valuation.

Sub-Dimension Effects

ESG Dimension	ROA (β)	Tobin's Q (β)	Significance
Environmental	**0.151**	**0.198**	$p < .01$
Social	0.072	0.081	$p < .10$
Governance	**0.119**	**0.167**	$p < .05$

Key findings:

- There are higher correlations between environmental and governance scores.
- Correlation of social score is less, yet has positive desirable effect.

DISCUSSION

The outcomes support the theory of stakeholder theory, which explains that companies implementing sustainability will be able to develop robust relationships and minimize risks and the companies will achieve greater improvement in the operational efficiency (Freeman, 1984). These findings are consistent with the earlier and recent studies (Clark et al., 2015; Whelan et al., 2021).

Of all, the Environmental performance has more chances to lead to the increased strategic value due to the improved use of resources, adherence to regulations, and reduction of environmental regulatory fines (Fatemi et al., 2018). The aspect of Governance would help in improving quality and minimizing agency problems that would facilitate market value (Chen et al., 2020).

CONCLUSION

This study supports effect as well as ESG score on the corporate financial performance of the emerging markets. It shows that the ESG score, in particular, the Environmental score and the governance score should be considered an investment because community score takes a constructive relationship, but through a lower percentage.

Implications

- Managerial Implications
- Add ESG to the core strategy.
- It should pay attention to improvements in governance and environmental efficiency.
- Communication of ESG activities by attracting responsible investors.

Policy Implications

- ESG reporting is to be made compulsory.
- Rewarding green bonds and sustainability-linked loans, as one of the ways of marketing responsible financial products.
- Investor Implications
- Sustained firm value is testified by ESG metrics.

Positive correlation to market valuation is an indicator of the significance of governance and environmental performance.

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