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ESG PRACTICES AND CORPORATE SUSTAINABILITY: EVALUATION, RISKS, AND ECONOMIC CONSEQUENCES

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Abstract: In recent years, more and more countries worldwide are paying attention to the risks and opportunities associated with sustainable development. This study examines the impact of ESG practices on firm sustainability, risk assessment, and economic value. Unlike traditional financial data, ESG metrics assess corporate sustainability from a non-financial perspective and have become key indicators for evaluating a firm's growth potential. This paper reviews the current state of ESG information disclosure and analyzes the effects of ESG practices on corporate risk, firm value, and capital costs. The findings indicate that higher ESG performance is generally positively correlated with a firm's market valuation and shareholder returns, while also helping to reduce information asymmetry and capital market risks. However, the existing ESG rating system lacks consistency and standardization, leading to significant discrepancies in the ratings provided by different agencies for the same firm.
Keywords: ESG performance; Information disclosure; Corporate risk; Firm value

1 INTRODUCTION

Sustainable development has become an increasingly important global issue. With the United Nations' call for action on the Sustainable Development Goals (SDGs) and growing investor attention to non-financial information, more and more countries are measuring, disclosing, and managing the risks and opportunities related to sustainable development. Unlike traditional financial data, Environmental, Social, and Governance (ESG) criteria assess corporate sustainability from a non-financial perspective, focusing on the economic value of a company. ESG indicators are considered crucial for reflecting a company's ability to create value and implement effective strategies, gradually becoming key metrics for evaluating a company’s development potential.

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In 2020, China set the goals of "carbon peak" and "carbon neutrality," highlighting its important role in global sustainable development. In response, various Chinese official departments have implemented multiple measures to meet sustainable development requirements, enacting or revising laws, regulations, and policies that require companies to take responsibility for environmental protection, social responsibility, and corporate governance. For instance, in 2002, China introduced the Corporate Governance Guidelines for Listed Companies, which were revised in 2018 to incorporate additional obligations related to environmental protection and social responsibility. Furthermore, in 2016, the Guiding Opinions on Building a Green Financial System were issued to encourage green investment and the development of a green financial system. In 2019, the "ESG Evaluation System for Listed Companies in China" was published to enhance public understanding of environmental protection, social responsibility, and corporate governance, emphasizing the concept of green development and the balancing of stakeholder interests. In 2023, the White Paper on ESG Practices in China was released to promote responsible investment and improve the ESG evaluation framework for Chinese companies. ESG focuses on environmental, social, and governance aspects, serving as both the core framework and intrinsic requirement for companies pursuing green development, as well as a key driver of high-quality economic growth.

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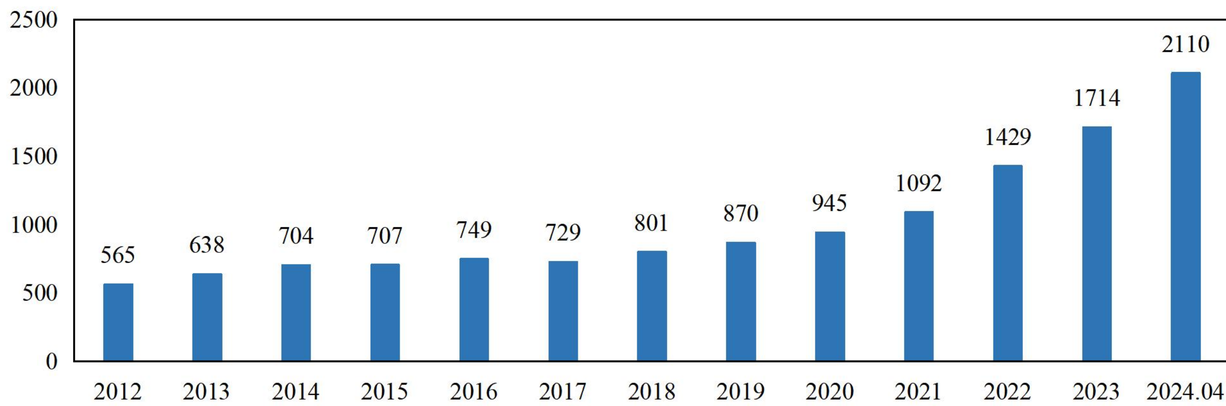

Figure 1 Number of Listed Companies Publishing ESG Reports (2012-2024.04)

As shown in Figure 1, this trend has been reflected in the capital markets and financial sectors, where ESG factors are increasingly integrated into business practices and corporate reporting. The growing scale of globally managed ESG assets further attests to this, with global ESG investments reaching $30 trillion in 2019, exceeding $35 trillion in 2020, and expected to surpass $50 trillion by 2025. According to the Bloomberg Intelligence ESG Investment Outlook report, it is anticipated that ESG investments will account for one-third of global investment management funds in the future. In developed countries, an increasing number of institutional investors are incorporating ESG factors into their investment portfolios. Existing research has examined the impact of corporate participation in ESG activities from various perspectives, discussing both the positive and negative effects of ESG engagement on corporate development.

2 ESG INFORMATION DISCLOSURE

Existing research primarily employs ESG ratings to measure ESG performance. Various methods are utilized to assess ESG performance, with most scholars adopt third-party ESG ratings as the primary standard for evaluation [1,2]. Additionally, some researchers have adopted content analysis methods to develop quantitative indicators of ESG disclosure levels, providing more detailed insights [3]. The level of ESG development within a company influences both its corporate growth and capital market performance. At the corporate level, firstly, companies with higher ESG ratings are able to attract more long-term value-oriented and sustainability-focused investors due to their outstanding sustainability performance [4,5].Secondly, these companies tend to have more favorable financing conditions and higher market valuations, which provide strong support for long-term business growth [6].Furthermore, positive ESG performance can enhance a company's brand image and reputation, increasing customer satisfaction and employee loyalty, thus fostering more robust stakeholder relationships [7].At the capital market level, the introduction of ESG ratings has also facilitated the reallocation of assets. An increasing number of investors are focusing on companies' sustainability performance, which has spurred the development of financial products such as green bonds and sustainability-linked bonds [8].
There is a notable divergence in ESG ratings provided by different agencies. The current ESG evaluation system faces significant challenges due to the lack of standardized criteria and methodologies. There is no standardized evaluation criteria for ESG ratings, and different agencies may disagree on the ESG ratings of the same company [9]. This divergence impacts both investor and corporate decision-making, diminishing the credibility and practical value of ESG ratings [1]. Pedersen et al. [10] argue that these discrepancies arise from substantial differences in the evaluation methods, weighting, and performance metrics used by different rating agencies. Berg et al. [2] further emphasize that the primary cause of rating inconsistencies lies in the subjectivity of the rating methodologies and the divergent interpretations of sustainability indicators. As a result, the discrepancies in ESG ratings not only have a direct impact on a company's financial performance and corporate value but also pose challenges to the company's long-term sustainability strategy and brand image [11,12].

3 ESG PERFORMANCE AND CORPORATE RISK

ESG disclosure can improve the information environment of companies. Gelb and Strawser [13] suggest that corporate social responsibility (CSR) activities provide more information and higher disclosure quality, leading to a better information environment. Cho et al. [14] examined the relationship between CSR performance and information asymmetry. By using various methods to measure CSR performance, such as information from business news, financial statements, and reports, they found a significant negative relationship between CSR performance and information asymmetry. Additionally, institutional ownership was found to influence this relationship. Similarly, Siew et al. [15] investigated the impact of ESG disclosure on market information asymmetry. ESG disclosure was found to negatively affect bid-ask spreads, and the presence of institutional investors reduces market information asymmetry. Thus, an enhanced information environment can lower corporate risk.

Engaging in ESG practices can enhance a company’s reputation and help establish a positive public image. Lee [16] posits that ESG/CSR reflects trustworthiness, honesty, and ethical behavior, which benefits company development. High levels of CSR are typically associated with greater cultural depth and ethical constraints within a company. Kim et al. [17] explored various dimensions and components of CSR and found that companies more engaged in CSR activities are less likely to engage in earnings management and operational manipulation. Bear et al. [18] demonstrated that CSR practices enhance a company's reputation by communicating its social responsibility efforts to investors and other stakeholders, thereby conveying credibility and trust to the public. When faced with negative events or threats, a responsible corporate image and reputation capital can play a crucial role. Olofsson et al. [19] showed that moral capital protects companies that perform well in environmental and social responsibility, increasing their resilience to external uncertainties and extreme market conditions.

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ESG practices are a long-term strategy that can suppress the motivation to conceal negative news. Mahoney and Thorne [20] argue that companies actively engaged in ESG tend to view it as an essential part of their long-term strategic plans. CSR is not only a key component of sustainable societies but also an obligation for companies pursuing long-term development. Companies with better ESG performance tend to reduce insider trading activities, which, in the long term, harm stakeholders' interests. Studies confirm that integrating ESG factors into investment processes helps investors reduce potential risks. Similarly, Porter and Kramer [21] found that incorporating ESG factors into decision-making can improve investment returns and lower potential systemic risks. If companies engage in responsible investment for long-term development, management is more likely to provide transparent and reliable financial reporting, thus maintaining strong relationships with investors, consumers, and suppliers. In this context, companies with strong CSR values are more likely to focus on long-term returns, diminishing the motivation for management to conceal bad news.

4 ECONOMIC CONSEQUENCES

ESG performance has a significant impact on various economic outcomes, such as a company’s cost of capital, corporate value, shareholder returns, employee satisfaction, and innovation capability. The cost of capital is a key determinant of a company’s financial efficiency and stability, playing a critical role in its high-quality development.

4.1 ESG performance and cost of capital

The cost of capital is an important factor influencing long-term investment decisions, consisting of equity and debt costs. Since ESG is still evolving, research on the impact of ESG practices on the cost of capital remains in the exploratory stage. On the one hand, most studies show a negative relationship between a company’s sustainability performance and both equity and debt costs [22,23]. La Rosa et al. [24] found that companies with strong CSR have higher credit ratings and can secure lower loan interest rates. Boubaker et al. [25] suggested that companies focusing on CSR are less likely to face financial distress. Christensen et al. [26] and Wong and Zhang [27] argued that negative ESG disclosures and discrepancies in ESG ratings impact debt financing costs. On the other hand, some studies reach opposite conclusions. Based on the over-investment and agency theory, these studies argue that ESG investments are often driven by management’s desire to enhance its own image, rather than to reduce the company's debt costs [28,29]. Over-investment in CSR and sustainable development may be seen as a means of improving corporate image, with shareholders bearing the costs of management’s actions [28]. Creditors consider the expenditures on sustainability, which results in companies with higher sustainability scores facing higher debt costs.

4.2 ESG performance and firm value

ESG performance reflects a company’s potential for sustainable operations. It enhances the company’s appeal to investors, reduces operational risks, and influences corporate valuation by strengthening brand reputation [30]. Firms with higher ESG ratings are able to reduce environmental risks, improve corporate social responsibility, and strengthen governance structures, thereby building a positive corporate image that attracts investors focused on long-term sustainability, thus boosting stock market value [31]. Companies with high ESG performance are often associated with higher stock prices and overall market capitalization, reflecting the market’s positive evaluation of these companies and optimistic expectations of their future profitability [32]. The existing literature emphasizes the importance of prioritizing and improving ESG performance in modern corporate management and investment decisions, revealing both direct and indirect contributions to a company’s long-term value creation.

5 CONCLUSION

The ESG evaluation system has become a crucial indicator of a company's sustainability capacity and has garnered increasing attention from investors, regulators, and corporate management. Companies can enhance their economic value and competitiveness through ESG practices, while also establishing a positive public image and improving resilience to external risks. However, the lack of consistency and standardization in ESG rating methodologies remains a significant challenge to its widespread application. There is a need to further refine and standardize ESG evaluation criteria to promote continuous progress in transparency, social responsibility, and green development, ultimately achieving higher-quality sustainable development.

COMPETING INTERESTS

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