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Discussion on the Correlation between ESG Performance and Corporate Value

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ABSTRACT
This study integrates existing research on ESG (Environmental, Social, and Governance) to explore its impact on corporate value. By analyzing drivers of ESG performance (e.g., policy, governance) and economic consequences (e.g., financing costs, market trust), we demonstrate that strong ESG practices enhance corporate value through risk mitigation and stakeholder confidence. However, overinvestment in ESG may harm profitability, highlighting the need for balanced strategies.

KEYWORDS
ESG; Corporate Value; Green Policies; Financial performance; Market Response; Information Effect; Strategical planning

1 Introduction

As ESG (Environmental, Social, and Governance) becomes a critical metric for corporate sustainability, its role in shaping corporate value remains debated. This study examines how ESG performance—driven by policy, governance, and market forces—impacts financial outcomes, risk management, and stakeholder trust. By integrating empirical evidence from Chinese listed companies, we propose strategic pathways to balance ESG investment with value creation.

2 Factors Affecting the ESG Performance in Companies

ESG is an important indicator for measuring the high-quality development of companies. It is also an important resource for companies. Through good ESG performance, companies can obtain more social and environmental resources, thereby enhancing corporate value. Therefore, understanding and controlling the factors that affect ESG performance is of vital importance.

2.1 External Impact on Company ESG

2.1.1 The Impact of Environmental Factors on Company ESG

The ‘dual carbon goals’ of achieving carbon peak before 2030 and carbon neutrality before 2060 demonstrate the Chinese government's great attention and firm stance on addressing environmental pollution and strengthening environmental protection. This means that implementing more environmental protection measures and enhancing social responsibility in economic production is the only way for every company to achieve sustainable development. Some scholars have found that increasing environmental protection investment can significantly improve corporate ESG composite scores by constructing moderating effect models and threshold effect models[1]. In the manufacturing industry of the main blocks of national production, there are many companies with high pollution and energy consumption problems. Practice has proved that establishing strong environmental regulations and carrying out transformation and upgrading can improve the ESG performance of companies and have a positive impact on their sustainable development[2].

2.1.2 Green Finance Generally Promotes the Performance of Company ESG

Scholars has found that the implementation of green finance policies has improved the ESG performance of companies. Among them, the promoting effect on the ESG performance of companies with low information asymmetry, high financial foundation, heavy pollution industries, and state-owned companies is more significant. In the short term, green finance can improve environmental performance, but it has no significant effect on financial performance[3].

2.1.3 Green Tax System has a Positive Impact on the ESG Performance of Heavy-polluting Companies

When a company's market value is low and financial risk is high, the green tax system can not only enhance the sustainable development ability of heavy-polluting companies and improve their ESG performance, but also enhance their social responsibility and improve the spillover effect of the company's green governance system[4].

2.1.4 Government Procurement has a Positive Incentive Effect on Improving Company ESG Performance

As the main body of the market economy, companies play a crucial role in the national economy. How the government can influence the ESG performance of companies to achieve the goal of high-quality development has become another important issue for decision-makers in the new era. Compared with previous fiscal subsidies and tax incentives, government procurement as a demand-side measure has become a fiscal policy to encourage companies' technological innovation[5]. By researching on Chinese listed companies as government procurement targets, scholars have found that government procurement plays a positive role in improving companies' ESG performance, especially for larger companies, heavily polluting industries, and those in the mature stage[6].

2.2 Internal Impact on Company ESG

2.2.1 Emphasizing New Development Concepts Will Have a Stronger Promoting Effect on Company ESG Performance

For the need of their own high-quality development, companies must build an ESG evaluation system with Chinese characteristics based on the implementation of new development concepts. Emphasizing new development concepts will have a stronger promoting effect on company ESG performance. In this regard, stated-owned key companies have always been the main force in implementing new development concepts. Empirical evidence shows that ESG can promote company risk management and enhance long-term returns[7]. Scholars conducted a horizontal comparison study based on the provincial government work reports from 2010 to 2020 and found that the higher the level of emphasis on new development concepts by local governments, the better the ESG performance of local companies[8].

2.2.2 Digital Transformation Plays a Positive Regulatory Role in the Impact of ESG Performance on Corporate Value

In current days, the digital transformation of companies is imperative. Its strategic guidance, technological drive, organizational empowerment, digital achievements all have a promoting effect on company ESG performance[9]. Domestic scholars has found data that shows a significant and stable "inverted U-shaped" relationship between the degree of digital transformation and company ESG performance[10]. The positive effect of digital transformation on corporate value can be achieved through two channels: green technological innovation and the quality of information disclosure. Green technological innovation plays a mediating role between digital transformation and ESG performance[11].

3 Economic Consequence of ESG

3.1 Market Response to ESG

Good ESG performance has a positive effect in the consumer market, which can enhance customer trust in companies, maintaining long-term strategic cooperation between supply and demand sides, thereby improving the stability of customer relationships and helping companies obtain high-quality transactions and more profits from consumers and supply chain[12].

3.2 Financing Impact of ESG

Companies with financing needs can obtain financing convenience and alleviate financing constraints through good ESG performance. Scholars has found that the better the ESG performance of a company, the lower its debt financing cost. The positive feedback of non-state-owned companies and those in regions with a high degree of marketization was particularly significant[13].

3.3 Information Effect of ESG

ESG has an information effect[14]. The disclosure of ESG information can reduce the problem of information asymmetry among companies in the supply chain. Transparent and traceable ESG performance can stabilize supply and demand relationships, optimize the matching of partners, and improve the quality of the supply side, thereby further enhancing the resilience of the supply chain[15]. Data shows that the better the ESG information disclosure performance of a company, the higher its concurrent stock price. This indicates that ESG information disclosure can influence investors' decision-making judgments by increasing the transparency of company information, thereby simultaneously raising stock prices[16].

3.4 Industry Implications

ESG principles are increasingly applied beyond traditional sectors. For instance, BYD's ESG leadership in the automotive industry has secured government subsidies and investor confidence, while the housing rental sector explores ESG metrics to improve operational transparency.

4 Impact of ESG Performance on Corporate Value

4.1 ESG Performance and Financial Performance

Most studies indicate a positive ESG-financial performance link, particularly in firms with green innovation capabilities. However, excessive ESG investment (e. g., in private firms) may raise costs and reduce short-term profits, suggesting industry-specific trade-offs.

4.1.1 Positive Relationship between ESG performance and Financial Performance

Studies have proved that the ESG performance of Chinese listed companies had a significant positive impact on company performance. In addition, due to the influence of the internal and external environment of enterprises, enterprises with high degree of innovation, low level of pollution, good corporate management, non-state ownership, and located in the eastern economically developed regions have relatively higher ESG ratings, and their positive impact on the financial performance of enterprises is more obvious[17].Research on the performance of Chinese companies going global shows that companies with ESG performance exceeding the industry average have much higher risk-taking capabilities and overseas returns than their competitors, and their income levels are more resilient[18]. Based on the positive correlation between ESG performance and company financial performance, many countries use ESG investment strategies to construct asset portfolios. China's urity funds have also been trying to incorporate ESG into investment management in recent years. Observations show that when achieving the same returns, social security funds bear lower risk. When the risk levels are the same, social security funds can obtain higher returns[19].

4.1.2 Negative Relationship between ESG performance and Financial Performance

Some scholars have found that there is a negative correlation between ESG performance and financial performance. Among all samples, private companies, low-emission companies, and those with high information disclosure have a more significant negative impact[20]. Excessive pursuit of ESG performance without considering the interests of the company may also cause damage to corporate value. For example, companies may face greater capital investment during the process of green transformation. Through literature summary and analysis, we can see that the relationship between ESG performance and financial performance is not absolute, and it is influenced by various factors such as company type, industry characteristics, and market environment.

4.2 The Relationship between ESG Performance and Corporate Risk-Taking

The Institute of Internal Auditors (IIA) has issued guidelines to apply the concepts and processes of Enterprise Risk Management (ERM) to ESG-related areas in order to better understand where the risk lie and to manage and disclose them effectively. Whether or not a company has risk-taking ability is crucial when facing risk in the market, society, or even within its internal structure. Research shows that in the current environment of increased capital market openness in the country, improving a company's ESG level can enhance its risk-taking ability[21]. Better ESG performance can significantly improve a company's risk resistance, and this promoting effect is more significant in companies with difficult access to resources, weak competitiveness in industries facing high-intensity competition, difficult financing, and privately owned[22].

A variety of factors play an important role in the relationship between a company's ESG performance and its risk-taking ability, including the company's governance capabilities, the industry's emphasis on ESG, and national policies. In the current context of economic downturn and fierce competition in the industry, managements should particularly pay close attention to the company's ability to withstand risks caused by fluctuations in ESG performance. They should quickly identify and assess the impact of known and unknown risks leading to poor ESG performance, improve internal management, make good strategic plan, and resource allocations, and support the achievement of high ESG goals.

4.3 The Relationship between ESG Performance and the Market

4.3.1 Increased Market Acceptance of Relevant Policies

Since the United Nations Principles for Responsible Investment (UN PRI) included ESG factors in the investment decision-making reference system in 2006, countries have actively established ESG evaluation systems that fit their market characteristics. China has developed and improved the evaluation of ESG indicators over the past 20 years, and released the ‘China Corporate ESG Report Rating Standard (2023)’ on 13 March 2023, officially establishing an ESG report rating system. Empirical evidence shows that this evaluation system has good acceptance in the Chinese capital market and has been initially recognized[23]. A company's ESG performance has become an important criterion for evaluating its competitiveness.

4.3.2 Maintain Production Chain and Customer Stability

Problems such as supply chain disruptions, industrial chain transfers, and loss of customer base in the real economy seriously affect the production and operation and even the development and survival of companies. The ESG performance of companies plays an important role in maintaining the stability of each link in the production chain and the customer base[24]. Good ESG information disclosure enhances the transparency of companies, reduces information asymmetry among investors, consumers, and other stakeholders, enabling all parties to objectively and comprehensively understand the company's production and operation, social responsibility, service status, and development prospects, thereby strengthening trust and loyalty to the company and improving the stability of the relationship between the company and various stakeholders; The role of ESG in maintaining the stability of the production chain and customers is particularly significant in heavily polluting companies, economically underdeveloped regions, and periods of relatively unstable social environment. From another perspective, companies can also promote the ESG performance of upstream and downstream companies through supply chain financial effects such as financing and monitoring[25]. Stable customer relationships can also promote the higher quality development of companies and its customers in the supply chain, forming a positive cycle in which all relevant stakeholders help each other[26].

5 Strategic Framework for Enhancing Corporate Value through ESG

Adhering to the national concept of green development, companies should incorporate energy conservation and emission reduction, resource management, etc. into their strategic planning. They should use more energy-efficient technologies and equipment, optimize production processes to reduce energy consumption and pollution emissions, increase the use of renewable energy, and encourage reuse and remanufacturing in the production process. They should also identify and assess the environmental risk faced by the company (such as climate change, national environmental protection policies, etc.), establish a complete environmental management system and formulate response strategies and contingency plans for environmental risk to ensure the stability of the company's operations. Apart from raising company’s own ESG level, they should also choose suppliers with good ESG performance to jointly develop ESG projects, improve the overall ESG level of the supply chain, and promote sustainable development.

Companies should create a good working environment and corporate culture for employees, ensure that employee salaries and benefits are in line with those of the same industry and the development of the company. They should also actively participate in community construction and development, carry out volunteer and social public welfare activities, and undertake more social responsibilities.

Potential risk exists that some company executives may sacrifice shareholder interests to participate in high-cost ESG projects. To avoid this kind of damage to corporate value, the company should build a highly operational ESG policy and ensure its full coverage and precise implementation, objectively evaluate the implementation process and effect of ESG policies, and make timely adjustments and optimizations based on actual conditions.

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