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ESG SCORES INFLUENCING THE FINANCIAL PERFORMANCE OF THE INDIAN COMPANIES

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Abstract:
This study provides insight into information regarding ESG scores and the financial performance of Indian companies. It uses data from 129 companies from 19 sectors collected from S&P Global Co. and analysed with descriptive statistics and OLS regression panel data with fixed effects in SPSS. The findings show that ROCE, ROA and ROE are positively related to the environmental score but not with the social and governance score; EPS are not affected by the ESG score in the Indian companies; PEG and PG are associated with the environmental and governance score but not with the social score. Many integrations of ESG analysis are considered for the financial performance of the companies. The ESG reporting is now essential for this era and its impact on investments too.

Keywords:
Environmental, Social, Governance, ROA, ROE, ROCE, EPS, PEG, PG, Market Cap

Introduction:

Several studies have been done on the relationship between economic expansion and its environmental influence for decades (Kuznets,1955). As per Asian Development Bank projections, with a 7.3 percent rise in GDP in the current fiscal year and a 7.6 percent increase in FY20, the Indian economy is expected to grow fastest in Asia (Economic Times, 2018). India has a long way to go before the damage industrial activity causes to the environment stabilizes. In the past ten years, the world has seen social activity, a growing threat from global warming and a lack of governance amid the global financial crisis. Due to such instances, there is a shared knowledge of the importance of socioeconomic development, environmental stability, ethical norms observance, holistic growth and responsible investment.

Some significant policy changes have occurred in India's regulatory environment over the past few decades. After being revised in 2013, section 135 of the Enterprises Act now requires qualifying enterprises to invest 2% of their net annual earnings in corporate social responsibility (CSR) projects (Companies Act,2013). In recent years, there has been a growing emphasis on sustainable and responsible investment strategies from the standpoint of Indian investors. Due mostly to the involvement of organizations like the United Nations Environment Program Finance Initiative, ESG practices-oriented portfolio selection methodologies have significantly increased investor appeal (Pandey, 2022).

Research Objectives

- To evaluate the ESG integration and financial performance across Indian companies.
- To investigate the relationship between ESG integration and financial performance for Indian companies.

Hypothesis

H0: There is no relationship between ESG scores and different financial metrics.

H1: There is a relationship between ESG scores and different financial metrics.

Literature Review:

The topic of ESG and its relationship with financial performance has been studied by researchers for the last decades. The growing investor interest in ESG practices reflected the view that environmental, social and corporate governance issues – including risks and opportunities can affect the long-term financial performance of companies and should therefore be given appropriate consideration in important decisions of firms (Ms. Deepmala,2022; Renuka Kumawat,2023). Furthermore, according to the results, firms with more disclosures regarding ESG improve firm valuation by reducing information asymmetry/risk. We can conclude from the findings that the environmental, social, and governance disclosure level derived from a potentially higher (or lower) quality accounting information system has implications for reducing the cost of capital (Francis et al., 2008). Furthermore, the study confirmed the link between disclosures related to ESG and the quality of earnings. The credibility of these disclosures can also be assessed by relating ESG disclosures with the quality of earnings as a source of their origin (Cohen et al., 2007; Francis et al., 2008; Dhaliwal et al., 2014). The findings of this thesis add to the current body of knowledge and deepen our understanding of the relationship between earnings quality, ESG disclosure, and financing choices in several important ways. The research draws on previous studies to overcome the inconsistent findings in the current debate on sustainable activities and their advantages. As a result, the thesis provides empirical support for stakeholder theory, which proposes that incorporating ESG practices and their additional disclosure promotes the formation of trust and confidence between firms and their stakeholders (Renuka Kumawat,2023). The importance of Environmental, Social, and Governance (ESG) aspects in investment decisions has grown significantly in today's volatile financial market. ESG investment performance in diverse regions, focusing on developed markets with high GDP, specifically the USA, Germany, Japan and emerging nations, India, Brazil, and China. We compare ESG indices against respective broad market indices, all comprising large and mid-cap stocks (Hemendra Gupta and Rashmi Chaudhary,2023). Several studies found that ESG investing can offer downside protection during market downturns, which is an important consideration for investors seeking to manage risk in their portfolios (Albuquerque et al. 2020; Broadstock et al. 2021; Engelhardt et al. 2021; Lau 2019). On the other hand, several studies indicate that ESG investment is not necessarily a surefire strategy to perform better during a crisis (Abedifar et al. 2023; Folger-Laronde et al. 2022). Also, Lashkaripour (2023) analysed that high ESG stocks have higher tail risk compared to low ESG stocks during a market crash. In 2017, the Kotak Committee made recommendations related to corporate governance, which improved standards concerning the corporate governance of listed companies in India. In 2018, BSE published a guidance document on ESG Disclosures. In 2019, the Ministry of Corporate Affairs revised the National voluntary guidance to align with the Sustainable Development Goals. In 2020, SEBI mandated a stewardship code with ECG Monitoring. In 2021, the Business Responsibility and Sustainability Report was launched by SEBI. It is mandatory for the top 1000 listed companies by market capitalization to file BRSR from the financial year 2022-23. Other companies may also disclose BRSR voluntarily (SEBI Consultation Paper, 2021).

Methodology:

Here, the data collected by S&P Global Co. includes the 125 ESG following companies from 18 different sectors of India. 125 companies are selected based on their market cap 9 from the Automobile sector, 8 from the Banking sector, 5 from cement, 1 from chemical, 2 from

	N	Range	Minimum	Maximum	Mean		Std. Deviation	Variance	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
ENV.SCORE	123	93	0	93	49.59	2.205	24.453	597.966	.045	.218	-1.135	.433
SOCIAL SCORE	123	89	0	89	53.05	1.866	20.697	428.358	-.008	.218	-.938	.433
GOVERNANCE SCORE	123	89	0	89	47.19	1.652	18.317	335.530	.027	.218	-.380	.433
ESG COMBINE	123	88	0	88	50.33	1.750	19.414	376.893	.056	.218	-.777	.433
RETURN ON CAPITAL EMPLOYMENT	124	174.37	-5.37	169.00	21.7625	1.91349	21.30772	454.019	3.799	.217	20.908	.431
RETURN ON EQUITY 5Y	117	149.60	-32.60	117.00	5.0057	1.70656	18.45923	340.743	3.185	.224	16.616	.444
RETURN ON EQUITY	121	191.00	-56.00	135.00	19.4799	1.70527	18.75794	351.860	2.011	.220	14.076	.437
RETURN ON ASSSTES 5Y	123	57.40	-20.10	37.30	8.5567	.75683	8.39364	70.453	.528	.218	2.152	.433
RETURN ON ASSTES	124	85.30	-41.30	44.00	9.4751	.88360	9.83935	96.813	-.298	.217	6.638	.431
EARNING PER SHARE	124	4140.07	-6.07	4134.00	125.2162	35.06821	390.50311	152492.681	9.041	.217	91.882	.431
PROFIT EARNING GROWTH	119	318.00	-66.00	252.00	4.9244	2.40537	26.23950	688.511	7.233	.222	68.410	.440
PROFIT GROWTH	123	5722.00	-97.00	5625.00	65.9008	45.72253	507.08741	257137.643	10.976	.218	121.287	.433
Valid N (listwise)	116											

Table 1 Descriptive Statistics of ESG following Indian Companies

construction, 26 from consumer goods, 10 from energy, 2 from fertilizers & pesticides, 10 from financial & non-banking, 1 from healthcare services, 8 from industrial manufacturing, 10 from IT, 6 from metals & mining, 2 from oil & gas, 15 from pharma, 2 from power, 4 from services, 3 from telecom and 1 from textiles.

Results:

Table 2.1 OLS Regression and Panel Data Regression with Fixed Effect

Model	Unstandardized Coefficients	Standardized Coefficients	t	Sig.	Correlations	Collinearity Statistics

		B	Std. Error	Beta			Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	29.309	5.408		5.420	.000					
	ENV.SCORE	.481	.154	.550	3.118	.002	.058	.275	.274	.247	4.044
	SOCIAL SCORE	-.565	.230	-.547	-2.453	.016	-.090	-.219	-.215	.155	6.464
	GOVERNANCE SCORE	-.028	.190	-.024	-.145	.885	-.082	-.013	-.013	.289	3.459

Dependent Variable: RETURN ON CAPITAL EMPLOYMENT

Table 2.2

Model		Unstandardized Coefficients		Standardized Coefficients			Correlations			Collinearity Statistics	
		B	Std. Error	Beta	t	Sig.	Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	13.988	2.477		5.647	.000					
	ENV.SCORE	.230	.071	.570	3.251	.001	.035	.286	.283	.247	4.044
	SOCIAL SCORE	-.268	.106	-.564	-2.544	.012	-.122	-.227	-.222	.155	6.464
	GOVERNANCE SCORE	-.034	.087	-.063	-.388	.699	-.120	-.036	-.034	.289	3.459

Dependent Variable: RETURN ON ASSETS

Table 2.3

Model		Unstandardized Coefficients		Standardized Coefficients			Correlations			Collinearity Statistics	
		B	Std. Error	Beta	t	Sig.	Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	28.054	4.899		5.726	.000					
	ENV.SCORE	.259	.139	.339	1.858	.066	-.028	.170	.168	.247	4.053
	SOCIAL SCORE	-.274	.209	-.303	-1.313	.192	-.128	-.121	-.119	.154	6.513
	GOVERNANCE SCORE	-.144	.171	-.141	-.837	.404	-.149	-.077	-.076	.290	3.454

Dependent Variable: RETURN ON EQUITY

Table 2.4

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations			Collinearity Statistics	
		B	Std. Error	Beta			Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	257.323	102.652		2.507	.014					
	ENV.SCORE	-1.222	2.927	-.076	-.417	.677	-.130	-.038	-.038	.247	4.044
	SOCIAL SCORE	-.290	4.373	-.015	-.066	.947	-.128	-.006	-.006	.155	6.464
	GOVERNANCE SCORE	-1.170	3.614	-.055	-.324	.747	-.123	-.030	-.029	.289	3.459

Dependent Variable: EARNING PER SHARE

Table 2.5

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations			Collinearity Statistics	
		B	Std. Error	Beta			Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	5.276	7.346		.718	.474					
	ENV.SCORE	.112	.198	.102	.565	.573	.002	.053	.053	.267	3.745
	SOCIAL SCORE	-.343	.297	-.260	-1.152	.252	-.029	-.107	-.107	.170	5.892
	GOVERNANCE SCORE	.261	.247	.175	1.057	.293	.032	.099	.098	.318	3.148

Dependent Variable: PROFIT EARNING GROWTH

Table 2.6

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations			Collinearity Statistics	
		B	Std. Error	Beta			Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	64.129	133.389		.481	.632					
	ENV.SCORE	5.868	3.789	.282	1.549	.124	.071	.141	.141	.249	4.018
	SOCIAL SCORE	-9.039	5.675	-.367	-1.593	.114	.000	-.145	-.145	.155	6.449

GOVERNANCE SCORE	4.040	4.690	.146	.862	.391	.043	.079	.078	.288	3.473

Dependent Variable: PROFIT GROWTH

Discussion:

The above analysis summarizes the hypothesized relationship between ESG integration and different financial performance indicators, such as ROCE, ROA, ROE, EPS, PEG, and PG as dependent variables and ESG scores as independent variables within the research framework. The awaited impact of the environmental (E) factor is predominantly positive and profitability metrics ROCE, ROA, ROE and growth prospects PEG, PG. It also suggests that environmentally responsible practices are expected to enhance financial returns and future growth. Conversely, the social (S) factor is generally hypothesized to have a negative association across all listed financial indicators, implying a potential trade-off or cost associated with social initiatives in the short term. The governance (G) factor presents a mixed picture, with an anticipated negative relationship with profitability ROCE, ROA, ROE and EPS, but a positive expected link with PEG and PG, indicating that strong governance structures might prioritize long-term sustainable growth and investor confidence over immediate profitability.

Conclusion:

Table of relationships

DEPENDENT VARIABLES	**INDEPENDENT VARIABLES**		
	E	**S**	**G**
ROCE	Positive	Negative	Negative
ROA	Positive	Negative	Negative
ROE	Positive	Negative	Negative
EPS	Negative	Negative	Negative
PEG	Positive	Negative	Positive
PG	Positive	Negative	Positive

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