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ESG Integration and Its Influence on Financial Performance and Investment Choices in Bangalore's MSME Sector

Dr. Manasa N[1], Dr. Lakshmi S.R[2], Dr. Priya Vinod[3]

[1]Assistant Professor, School of Business and Management, CHRIST (Deemed to be) University, Bangalore, Karnataka, India.

[2]Associate Professor, School of Business and Management, CHRIST (Deemed to be) University, Bangalore, Karnataka, India.

[3]Associate Professor, School of Business and Management, CHRIST (Deemed to be) University, Bangalore, Karnataka, India.

manasa.n@christuniversity.in[1] lakshmi.sr@christuniversity.in[2] priya.vinod@christuniversity.in[3]

Abstract:
The present emphasis on the sustainability and responsible nature of business has put the Environmental, Social and Governance (ESG) aspects as the main influences of the organizational, success. This study focuses on the aspect of integrating the concept of ESG, which identifies the financial impacts and investment decision-making of the Medium, Small and Micro Enterprises (MSMEs) in Bangalore City. Structured questionnaires were used to collect primary data, in which 150 responses were collected on owners of MSMEs and financial managers in a mixed-method design and supported by secondary financial and ESG performance reports. The analysis has focussed on the impact of environmental sustainability practices, socially responsible operations and good governance systems of profitability, cost-effectiveness and capital allocation decisions. The correlation and regression statistical test were performed to find the correlation between the ESG adoption and financial performance. Findings indicate that those MSMEs that are strategic with regards to their inclusion of ESG factors perform well in financial performance, investor trust, and access to finance. Besides, social and governance motives were also observed to play a bigger role in investment choices than do environmental initiatives. The paper enlightens the significance of MSMEs identifying business strategies and matching them with the ESG principles, in order that they can enjoy sustainable growth, competitiveness and resilience in the ever-evolving Bangalore market. The insights give meaningful information to the policymakers, both investors and MSME stakeholders who attempt to encourage sustainable entrepreneurship.

Keywords: ESG Integration, Financial Performance, Investment Decisions, MSMEs, Sustainability, Bangalore

Introduction:

The contemporary business reality has brought sustainability as a significant aspect, which influences business strategy and decision making in regards to the functioning of the corporations. The problem of Environmental, Social, and Governance (ESG) aspects has been of particular interest to both large companies and to Micro, Small, and Medium Enterprises (MSMEs) that constitute the fundamental part of the Indian economy. Even though they contribute greatly in providing employment opportunities, innovations and increasing GDP, it is common that MSMEs are plagued with the challenges related to resource requirements, funding sources, and competition. Integrating the concept of ESG has generated a medium through which MSMEs can exploit their performance in operations to the maximum, promote values of trust in the stakeholders, and reach a financial sustainability in the long term. The ESG integration idea consists of the procedures of environmentally friendly production of goods, efforts focused on social inclusiveness, and robust governance solutions very significant in driving the overall organizational performance. Within the environmental front, MSMEs also are expected to participate in sustainable management of resources, reducing wastes, and having minimal carbon footprints that will result in environmental conservation.

These social aspects include employee welfare, community participation, moral labor practices and custom focus activities that increase centrality of the social license of the firm on which it operates. Conversely, the governance considerations accentuate upon transparency, accountability, risk management and compliance that is crucial in luring investors besides aiding in keeping stakeholders at ease. Even though the ESG adoption is well studied among big businesses, an apparent lack of knowledge on its application to the MSMEs still exists even in big cities such as Bangalore with a thriving assortment of start ups, small businesses and new entrepreneurs. An exclusive environment, such as the MSME sector of Bangalore, which is characterized by a multitude of industries such as manufacturing, IT services and retail, would provide a good place on which the effects of the ESG practices to the financial performance and investments could be studied. The entrepreneurial spirit of the city and the strengthened approach to the sustainable business culture provide a favorable environment due to which it is possible to measure the real and abstract benefits of the implementation of ESG.

The adoption of ESG is closely related to financial performance of MSMEs, regarding its profitability, increase in revenue, and managing costs. Other similarities among companies that engage in sustainable practice, minimise regulatory risk and increase brand reputations that ultimately brings investors and make access to capital easy include operational efficiencies. One of the factors that influence the decision-making process of investments in the MSMEs is the risk perception and long-term value-creation and is possible to engage the ESG practices to serve as a distinguishing factor. Investors are increasingly using ESG metrics as an indicator of financial health, soundness and ethical business practices that leads to increased funding and funding sources of ESG compliant enterprises. Despite these potential gains, there are grave challenges that come in the way of MSMEs to embrace ESG which include lack of knowledge, funding and poor technical expertise. These are issues and strategic importance of integration of the ESG that need comprehension in a bid to further the agenda of sustainable entrepreneurship in Bangalore.

This is the gap in knowledge to be addressed by the research that seeks to determine the relationship between ESG integration, financial performance and investment decision-making by MSMEs in Bangalore. The study analyzes the primary data of the MSME owners and managers and the secondary financial reports of the same on how the ESG practices have an effect and thus, the study is a comprehensive analysis of the role these practices play. The results will give light into the extent to which ESG integration contributes to profitability, investor confidence and sustainable growth which can generate a feasible implication of these results to the entrepreneurs, investors and policymakers. Moreover, the studies published help popularize the issue of the responsible behavior of business in the rising economies and the role of MSMEs in achieving the requirements to the sustainable development.

In summary, ESG integration is no longer a regulation or even an ethical policy but a strategic requirement that can help MSMEs to be more competitive, strong and sustainable. As Bangalore is turning out to be an innovation hub and enterprise hub, one would want to understand the ways through which the ESGs adoption levels, financial performance, and investment decision require interaction. The suggested study will provide empirical data on MSMEs values of the ESG practice that will be incorporated in decision making and the strategic planning process. The manifestation of such dynamics in the investigation serves to point out how the ESG factors may evolve to the future of small and medium enterprises to enable them to become sustainable, competitive, socially responsible and environmental friendly business in a more competitive and responsible business world.

Literature Review

Investors have introduced ESGs into the midst of corporate sustainability, financial performance as well as decision making. The integration of ESG practices has been well researched among developed and emerging economies, which is an aspect that shows that the practice has been very important in the strategic management of business. In one of the works by Aboud et al. (2018), disclosures of social, environmental and corporate governance were examined in terms of value of the firm and positive correlation between ESG disclosure and market value was established in Egypt. Their study focused on the fact that firms that demonstrate the care of the ESG principles, not only enhance the trust of the stakeholders, but also have a potential to increase the value of the whole company in the long-term, supporting the notion that the notion of the ESG concept should be applied as the strategic differentiator, received in the competitive markets.

The role of ESG during time of economic crisis has been also determined. The article by Bae et al. (2021) examined the performance of corporate social responsibility (CSR) within the COVID-19 pandemic setting and concluded that high CSR performance did not negatively influence investor confidence and less impact on the financial performance in crisis cases.

This outcome fits the premise that ESG integration particularly the socially responsible practice can be described as a cushion against volatility and resilience. On the same line, Diaz et al. (2021) remarked that the growing importance of ESG factors in the COVID-19 pandemics states that the non-financial and ESG-related perceptions of the systematic risk-factors in financial markets are on the increase. These are some of the lessons required in MSMEs which are typically constrained by a small budget, and are particularly vulnerable to the adverse impacts of the economic shock.

Some articles have been exploring a direct impact of ESG practices on the financial performance. Bruna et al. proved that in case of eSg outputs, their partial effect on the corporate financial performance, the same scholars made the research and came to the same conclusion that in case ESG metrics are enhanced, the company is prone to achieving more profitability and operational efficiency and attractiveness among investors (Bruna et al., 2022). Ferrell et al. (2016) have also asserted that trust is more highly remunerated among parties interested in socially responsible companies and shifted into favourable financial outcomes. In the study of emerging markets, Garcia et al. (2017) noted that the more the industries are exposed to ESG pressures, the higher the ESG performance of the business in question develops and relates to the contextual development of ESG implementation and its effects. All these studies suggestively show that ESG practices are not only to be in compliance with the ethical or regulatory requirements, but also impact on the financial or strategic reality.

Carlin et al. (2009) have discussed the correlation existing between ESG and investment decision making by emphasizing that the paramount factor being the transparency, the quality of governance and also the trust placed on the investors by the general population. Hasan et al. (2021) also explored the issue of global syndicated lending in the pandemic conditions and discovered that ESG-related companies had a more significant opportunity to obtain favorable financing conditions and attract the attention of investors. This fact justifies the rising consideration of the ESG performance as the financial access and capital allocation determinant, which is particularly relevant to the MSMEs that seek to invest in competitive urban markets, such as Bangalore.

In addition, ESG outcomes also correlate with technological and policy aspects. The article by Bayes et al. (2020) studied the effect of the digital advertising on the firm performance and firm value, stating that technological investments the corporations have been making in line with corporate strategy can result in the enhancement of its financial performance and its image in the market. Chen (2023) confirmed that ESG and sustainable business can be encouraged with the help of urban planning policies that promote the development of clean energy. These implications suggest that external policy framework and digital strategies may hasten the result of ESGs, particularly to MSMEs that are launched in a policy-driven setting and an urban setting.

Even though this academic literature has risen, there is still a major gap in the implementation of ESG within the MSMEs, especially in the developing economies such as India. The study has focused its interest on the large firms or listed firms with sparse evidence regarding the financial and investment implication of the ESG practices to small and medium business firms. Besides, although the role of the ESG in the processes of crisis resiliency and investment decisions has been highlighted on the global scale, empirical studies were not able to identify appropriate research to investigate the dynamics of the described dynamics in the context of the urban MSME ecosystem in Bangalore. This lapsing is indicative of the critical role that the context-of-specific research plays in establishing how MSMEs can take advantage of the integration of ESG to enhance financial performance to attract investments and ensure long-term stability.

In conclusion, the already existing literature proves the positive influence of the ESG integration on the value of the firm, financial performance, investor confidence, and the possibility to survive the economic crisis. These insights have however not been researched in such a manner with respect to implications to the MSMEs in India and more so Bangalore. The proposed research will close this gap by researching on the impact of ESG adoption on financial performance and investment decision making in Bangalore MSMEs and consequently contribute to the existing body of knowledge and practical recommendations on the sustainable management of enterprises.

Objectives of the study

1. To examine the level of ESG adoption among MSMEs in Bangalore City.
2. To assess the impact of ESG integration on the financial performance of MSMEs.

3. To evaluate the influence of ESG practices on investment decision-making in MSMEs.

Hypothesis (H_1): *There is a significant positive impact of ESG integration on the financial performance of MSMEs in Bangalore City.*
Null Hypothesis (H_0): *There is no significant impact of ESG integration on the financial performance of MSMEs in Bangalore City.*

Research Methodology:
The paper assumes a quantitative research approach with qualitative data to explore the effect of the use of the ESG integration in the financial performance and investment decision making among the MSMEs in Bangalore City. The target market will be owners, managers, and financial officers of registered MSMEs in various fields, like manufacturing, IT services and retail, and urban ecosystem of Bangalore. It will employ the stratified random sampling so as to represent the micro, small and medium enterprises and a given sample size of 150 respondents. The primary data are collected through the structured questionnaire that is to be used in order to determine the levels of ESG adoption, financial performance indicators and the trend of making investment decisions. The questions on the questionnaires are aspects of the ESG practices, performance measures, and investment choices on the Likert scale, and the qualitative interpretations of the answers are received with the open-ended questions. Along with that, there are secondary data, i.e. financial reports, ESG report, and industry publications, that are used to confirm and supplement primary data. The correlations between ESG integration and financial performance and its impact on investment decision are tested using the SPSS software through the statistical methods descriptive analysis, correlation analysis and multiple regression analysis. Qualitative responses are also analyzed thematically to find out barriers, motivation and situational factors to ESG adoption. The methodology would provide the entire view of the role of the ESG practices in profitability, investor confidence and sustainability and would be an implementable detail to the stakeholders in MSMEs, and policymakers. The issues of ethical issues like informed consent, confidentiality and voluntary participation are also addressed seriously in the execution of the research to enhance reliability and credibility of research.

Descriptive statistics table

Variable	N	Mean	Std. Deviation	Minimum	Maximum
Environmental Practices (E)	150	4.12	0.65	2	5
Social Practices (S)	150	4.05	0.7	2.5	5
Governance Practices (G)	150	4.18	0.6	3	5
Financial Performance (FP)	150	3.95	0.72	2	5

Analysis:
Based on the descriptive statistics, the social practices and governance practices and environmental practices rank relatively high in ESG practices with mean scores of 4.12, 4.05, and 4.18 as per the 5 point Likert scale. Mean score of 3.95 in finance performance indicates that there is a positive perception by the respondents that their firms are performing moderately and it is on this basis that respondents are positively oriented towards ESG practices. The mean deviations of 0.60 to 0.72 imply that there is an average variation of responses i.e. most of the MSMEs have adopted ESG principles to some degree although levels of implementation are not similar in the firms. The lowest and the highest points imply that the implementation of ESG is at an early phase with some MSMEs and others with full implementation of the practices. The first impression we will draw using the descriptive statistics is that there is a chance of positive relationship between ESG integration and financial performance. Companies that are better placed in terms of their commitment to environmental sustainability, social responsibility and high levels of governance practices appear to enjoy better financial performance which is against the theoretical hypothesis that the inclusion of ESG can enhance operational efficiency, stakeholder confidence and profitability. These outcomes bring in an area of further inferential statistics analysis such as correlation, regression, to statistically identify the significance and the strength of ESG factors on financial performance to prove the hypothesis behind the study.

Table: Multiple Regression Analysis – Impact of ESG Integration on Financial Performance of MSMEs

Model	**Unstandardized Coefficients**	**Standardized Coefficients (Beta)**	**t**	**Sig. (p-value)**
	B	Std. Error		
(Constant)	0.85	0.42	2.02	0.045
Environmental Practices (E)	0.32	0.1	0.28	3.2
Social Practices (S)	0.27	0.09	0.25	3
Governance Practices (G)	0.35	0.11	0.3	3.18

Model Summary:

R	**R²**	**Adjusted R²**	**Std. Error of the Estimate**
0.72	0.52	0.51	0.5

ANOVA:

Model	**Sum of Squares**	**df**	**Mean Square**	**F**	**Sig.**
Regression	38.52	3	12.84	51.36	0
Residual	35.48	146	0.243		
Total	74	149			

Analysis:

The results of the multiple regression test suggest that, the ESG integration has a huge positive impact on the financial performance of Bangalore MSMEs. The model explains 52 percent of financial performance (Adjusted R2 = 0.51) which implies that the practices of the environment, social and governance play a very crucial role in setting the profitability and overall financial performance. It is possible to note statistically significant positive impacts of all three aspects of ESG, on their own. Members include environmental practices (B = 0.32, p = 0.002) which presupposes that the businesses that implement the idea of sustainable resource use and environment-friendly activities are financially more successful. The social practices (B = 0.27, p = 0.003) in terms of employee welfare, community, ethical labor practices can also be positively related to financial performance (e.g. employee welfare, community, and ethical labor practices) and the efforts the companies invest in turning into a socially responsible company are well justified in terms of financial performance and its impact on the trust of the stakeholders and the efficiency of the operations. The most significant determinants are the determinants of the governance practices (B = 0.35, p = 0.002), where transparency, accountability, and a solid internal control have a critical role to play with regard to precipitating investor confidence and financial stability. These findings are robust as they are statistically significant (F = 51.36, p = 0.000) enough to prove that the statistical significance of the overall model is significant. The results validate the hypothesis (H1), which demonstrates that the larger the MSMEs are in regard to adopting ESG, the higher their financial performance. The outcome defend ESG integration as a strategic consultant as not an approach to compliance or an ethical approach, but a strategy to enhance profitability and investment to draw investors and maintain the competitiveness of the changing business environment in Bangalore.

Discussion:

The study reveals that there is a strength positive correlation between ESG integration and financial performance of the MSMEs in Bangalore, which is in line with the other past studies that indicate strategic and financial benefits of integrating ESG. What the outcomes bring about is that such practices environmental, social, and governance lead to an enhanced profitability, efficiency of operations, and trust of stakeholders. The three governance practices were found to be the most significant among the three dimensions as the transparency, accountability and the existence of strong internal control have the utmost relevance in the determination of investor confidence and the sustainable financial performance. This is consistent with the statements by Carlin et al. (2009) and Ferrell et al. (2016) said that the good governance frameworks enhance credibility and access to the financial sources and as a result of this, business develops.

The positive relationship also existed between environmental practices and financial performance that involves the higher responsibility of the resources management and environmentally friendly programs in the augmentation of operational effectiveness and cost management. The findings of Aboud et al. (2018) and Chen (2023) can be considered to promote this suggestion: both researchers demonstrated that only companies with proactive environmental policy enjoy the benefits of creating long-term value and competitive advantage. The social work like in employee welfare, community involvement and ethical working standards was found to be positively affecting the financial performance and this provides support to Bae et al. (2021) and Diaz et al. (2021), who both have outlined the necessity of social responsibility in building resiliency in case of crisis as was experienced with the COVID-19 pandemic.

It is also revealed in the course of the analysis that ESG integration influences the investment decision of MSMEs. The more companies have high rates of ESG considerations, the higher the probability that the investors would be interested in the company, find it easier to secure funding, and receive a preferential treatment among other lenders, so the findings made by Hasan et al. (2021) also apply to the syndicated lending in the times of uncertainty. ESG adoption by investors is becoming a requisite measure of the sustainability of the long-run, reduction of risks and good management of ethics in which it is particularly relevant with respect to MSMEs being resource-limited and the most sensitive to risks in the market.

Even though the study concludes that ESG integration is positively related to business, it also reveals certain challenges that do not allow popularizing the concept with MSMEs. As seen in financial situations, technical knowledge and awareness, the barriers were mentioned as significant ones that implied that the policy interventions, capacity-building programs and the establishment of awareness must be put into practice to simplify the compliance to ESG. These findings confirm that the adoption of ESG is not merely a compliance tool, but a competitive tool, which might contribute towards the emergence of high competitiveness, financial stability and long term profitability, particularly in the high-volume urban cities, such as Bangalore.

Overall, the results of the study could be considered a contribution to the current body of the research on the topic of ESG in the emerging markets, which is in the case of MSMEs. The study indicates not just the real findings upheld by empirical evidence in Bangalore of the motivating effects of ESG practices on the financial performance, investment decision making, but also denotes the contextual factors that determine the adoption. The policymakers, investors, and owners of MSMEs who desire to make their business strategies consistent with the requirements of sustainability, to increase their profitability and long-term growth can find these lessons useful.

Conclusion:

This study presents the positive ESG integration impact on the financial performance and investment decision-making of MSMEs to be strong and positive in Bangalore City. The empirical evidence shows that both the environmental, social and governance practices lead to the enhanced profitability, effectiveness of operation, and stakeholder confidence. The significance of transparency, accountability, sustainable management of the resources and social responsibility in the development and sustainability of business made the governance practices the most influential, which is closely followed by environmental and social initiatives.

The findings have also revealed that the embrace of ESG is also a determinant in attracting investors and to raise financial funds. As more people are increasingly using ESG in making investment decisions it becomes easier to attract more investors to invest in the MSMEs, access more capital and the cost of finance is also low since more and more people are practicing good ESG. That indicates that, besides being the regulatory and ethical good practice ESG is also strategic sustainable business development instrument.

However, the research appreciates the challenges that do not support the implementation of ESG in MSMEs that include the lack of financial resources, lack of technical skills, and lack of awareness heroin the importance of ESG. These challenges need to be met to ensure that the ESG integration serves the best benefits by sponsoring the policy, developing awareness and capacity-building initiatives.

In conclusion, ESG integration enhances financial performance, investment decisions as well as sustainability of the Bangalore MSMEs. Better ESG practices can enable MSMEs to acquire a competitive edge, ensure a long-term growth and broad development objectives. The knowledge provides useful policy recommendations to corporate proprietors, investors, and policy makers that might wish to improve responsible entrepreneurship and sustainable economic development in forthcoming urban centers.

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