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Divergence in ESG Ratings and Its Impact on Corporate Reputation and Management Strategies

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Abstract: With the growing global focus on climate change and environmental issues, the significance of Environmental, Social, and Governance (ESG) considerations within corporations is increasingly paramount. In the context of the current "green environmental protection" paradigm, ESG, as a product of the new era, aligns seamlessly with China's sustainable development philosophy. Based on this context, this paper elucidates the composition of divergences in ESG ratings and discusses the implications and impacts of these divergences on corporate reputation and management strategies based on relevant theories. This paper provides a reference for understanding the disparities in ESG ratings among different enterprises and their resultant impacts.

Keywords: ESG Rating Divergence, Corporate Reputation, Management Strategy

1. Introduction

In his report to the 20th National Congress of the Communist Party of China, General Secretary Xi Jinping stated, "Enterprises have not only economic and legal responsibilities but also social and moral responsibilities." "Only entrepreneurs who sincerely give back to society and effectively fulfill their social responsibilities can truly be recognized by society and are entrepreneurs who meet the requirements of the times." These significant remarks clarify the direction for the implementation of China’s ESG development theories and sustainable corporate development, further embedding the concept of green environmental protection into the public consciousness. Therefore, analyzing the emergence of ESG rating divergences and elucidating their content is crucial for assessing their impact on corporate reputation and management strategies.

2. Emergence of ESG Rating Divergence

ESG rating refers to the scoring of a company's environmental (E), social (S), and governance (G) aspects by ESG rating agencies based on the company's published corporate social responsibility reports and other available data. These agencies then produce a comprehensive ESG rating for the company or investment portfolio according to their respective indicator systems.

Analysis of Domestic and International ESG Rating Divergence:

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There are significant cultural and social differences between domestic and international ESG rating agencies, leading to variations in evaluation criteria. Regardless of factors such as "local preferences," institutional backgrounds, ownership attributes of companies, and "implicit" social responsibilities, as well as ESG ownership disclosures, it is not feasible to apply uniform requirements uniformly across all contexts [1].

Analysis of Domestic ESG Rating Divergence:

2.1. Differences in Indicator Measurement

For major domestic ESG rating agencies (such as China Securities Index, Huazheng Index, and Shangdao Ronglv), there are significant discrepancies in the ESG performance ratings of individual domestic companies. The lack of universally standardized ESG measurement criteria leads to considerable disparities in how different data providers measure and evaluate ESG.

2.2. Differences in Weighting Setting

Domestic scholars have studied the differences in weighting among three databases. The results show that in CNRDS, the social dimension has the highest weight, nearly three times that of the other two dimensions. In CSMAR, the environmental dimension has the highest weight, nearly twice that of the social and governance dimensions. For Wind, the social dimension has the highest weight, approximately three times that of the environmental dimension [2].

2.3. Textual Divergence in ESG Reports

ESG rating agencies' judgments and evaluations depend on the quality of ESG reports. In their assessments, ESG rating agencies consider whether these reports are comprehensive, balanced, and quantifiable enough. Therefore, the quality of ESG report texts voluntarily published by listed companies decisively influences the ESG ratings of these companies.

2.4. Other Reasons for ESG Rating Divergence

2.4.1. Governance Structure and Mechanisms

The governance structure and mechanisms of companies in ESG may vary due to different social systems. For example, some countries may emphasize corporate social responsibility and sustainable development, while others may prioritize profitability and economic benefits. This difference can lead to discrepancies in companies' decisions and actions regarding ESG.

2.4.2. Expectations and Demands of Stakeholders

Decisions and actions of companies in ESG may be influenced by various stakeholders. For example, investors, consumers, governments, employees, and the general public may have different expectations and demands from companies. These expectations and demands may vary due to different social systems and cultural backgrounds, leading to discrepancies in companies' ESG approaches.

2.4.3. Regulations and Policies

Regulations and policies in different countries and regions may have varying impacts on companies' decisions and actions regarding ESG. For instance, some countries may have strict environmental regulations, requiring companies to adhere to certain environmental standards during production,

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while others may have more lenient regulations. This difference can lead to discrepancies in companies' decisions and actions regarding ESG.

2.4.4. Culture and Values

The cultural backgrounds and social systems of different countries or regions may result in varying values among companies regarding environmental, social, and governance aspects. For example, some companies may prioritize economic benefits and profit maximization, while others may prioritize social responsibility and sustainable development. This difference can lead to discrepancies in companies' decisions and actions regarding ESG.

2.4.5. Inconsistent Rating Standards

Different rating agencies may have different opinions on which factors significantly impact the environmental (E), social (S), or governance (G) aspects and the weights of these factors in ratings. Additionally, standards used for comparing specific industries may differ, with some using relative benchmarks and others using absolute benchmarks.

2.4.6. Discrepancies in Data Collection

ESG ratings rely on extensive data collection and analysis, but there may be discrepancies in data acquisition. On one hand, different data sources and channels may provide different information, potentially leading to divergent rating results. On the other hand, the accuracy and completeness of data may also affect rating outcomes.

2.4.7. Company Self-Reporting and Transparency

If companies do not adequately disclose their performance in ESG or if the disclosed information is inaccurate, rating agencies may be unable to make accurate assessments, resulting in divergence.

3. Impact of ESG Rating Divergence on Corporate Reputation

Corporate reputation is a crucial factor for companies to gain competitive advantages. The perception of a company's reputation depends on its image and status among various stakeholders. ESG performance comprehensively measures a company's social, environmental responsibilities, and corporate governance. A strong ESG performance can help companies establish a positive public image, send positive signals to various market participants, and consequently build a good corporate reputation. With this in mind, this paper, based on the perspective of signal transmission, combined with panel data from some listed companies in China from 2011 to 2021 [3], and measured corporate reputation [4], studied how ESG performance affects corporate reputation. The research found that ESG rating divergence may impact companies in the following aspects:

3.1. Complexity of Investment Decisions

For investors, ESG ratings are crucial investment decision references. However, when there is divergence, investors may face decision-making difficulties, unsure which rating agency's standards to follow. This uncertainty may increase investors' risk perception, thereby influencing investment decisions regarding companies.

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3.2. Ambiguity in Market Perception

ESG rating divergence may lead to ambiguity in the market's perception of companies. When multiple rating agencies provide different rating results, the public and investors may be confused about the true situation of the company, which is not conducive to establishing a clear and distinct brand image for the company.

3.3. Uncertainty in Corporate Strategy

When formulating ESG strategies, companies usually refer to rating agencies' recommendations and standards. However, ESG rating divergence may introduce uncertainty for companies in formulating and executing strategies. Companies may need to spend more time and effort addressing the requirements of different rating agencies, potentially diverting attention from their core business development.

3.4. Decrease in Trustworthiness

ESG rating divergence may lead to a decrease in the public and investors' trust in a company's true performance. If there are significant differences in rating results from different rating agencies, the public and investors may doubt the company's integrity, thereby affecting perceptions and attitudes towards the company.

3.5. Impact on Brand Image

ESG rating divergence may damage a company's brand image. The company may be perceived as lacking in environmental, social, and governance aspects, thereby affecting its image among the public and investors. This damage to the brand image may impact the company's market competitiveness and even lead to the loss of customers and partners. 6. Stock Price Volatility: ESG rating divergence may affect a company's stock price. If there is divergence in a company's ESG rating, investors may doubt the company's future prospects, leading to stock price volatility. This volatility may have a negative impact on the company's market capitalization and financing capabilities.

ESG rating divergence is crucial to corporate reputation. In implementing the national green environmental protection concept and adhering to corporate sustainable development, enhancing corporate reputation can be approached from the following aspects:

First, clarify the company's ESG strategy: Companies should clarify their ESG strategies and goals, ensuring that all stakeholders understand and agree with these strategies and goals. This will help companies maintain consistency when facing ESG rating divergence, reducing reputational risks.

Second, strengthen communication with rating agencies: Companies should actively communicate with rating agencies to understand their evaluation criteria and methods, ensuring that their ESG performance aligns with these standards. At the same time, companies can provide their own data and information to rating agencies to help them more accurately assess the company's ESG performance.

Third, publicly disclose ESG information transparently: Companies should transparently disclose their ESG information, including environmental, social, and governance data, policies, and achievements. This will help enhance the understanding and trust of the public and investors in the company, reducing the impact of ESG rating divergence on corporate reputation.

Fourth, strengthen ESG awareness training: Companies should enhance internal education on ESG awareness, ensuring that employees understand the importance of ESG and actively practice it in their daily work. A company with a strong internal consensus on ESG principles can respond more confidently and firmly to external ESG rating divergence.

Fifth, involve diverse stakeholders: In addition to rating agencies and investors, companies should actively communicate their ESG strategies and performance to other stakeholders such as customers, suppliers, partners, and employees. Through the participation and feedback of diverse stakeholders, companies can gain a comprehensive understanding of their ESG performance, identify and improve existing issues in a timely manner, and continuously improve and innovate. ESG rating divergence provides opportunities for companies to improve and innovate.

Finally, strengthen international cooperation and exchange in the face of ESG rating divergence: Companies can enhance cooperation and exchange with international peers and partners to jointly promote the improvement of ESG standards and evaluation methods. Through international cooperation, companies can learn from the successful experiences of other companies, jointly address ESG challenges, and adapt to the divergence in ESG ratings.

4. ESG Rating Divergence and its Impact on Management Strategies

4.1. Analysis of Characteristics of Traditional Enterprise Management Concepts

Traditional enterprise management strategies typically focus on improving production efficiency and maximizing corporate and shareholder profits, often overlooking their "ecological-human" attributes. In recent years, environmental awareness has become increasingly important, leading to the emergence of new energy companies. However, some companies, considering the operational risks associated with fulfilling environmental responsibilities, prefer to pay fines rather than improve related measures. The emergence of ESG ratings has, to a certain extent, promoted the transformation of companies from being purely "economic entities" to "ecological entities" [5], achieving rational effects [6].

4.2. Impact Orientation of ESG Rating Divergence on Corporate Management Strategies

4.2.1. Establishing the Concept of Corporate Sustainable Development

Corporate social responsibility refers to a company's obligation to not only fulfill legal responsibilities in production and operation but also to bear responsibilities to stakeholders such as shareholders, investors, employees, customers, suppliers, partners, and the public. Against the backdrop of the previous "dual-carbon" environment, the transformation of corporate management concepts requires companies to find a balance between economic and environmental benefits, adopt more environmentally friendly production methods, reduce waste emissions, and improve resource utilization efficiency [7]. Additionally, in the macro environment, empirical evidence suggests that good ESG investment can help companies' stocks decrease less during market downturns and recover faster during market upturns, forming a good protective mechanism.

4.2.2. Balancing Economic, Social, and Environmental Benefits

Under the influence of the ESG concept, companies should actively assume more social responsibilities to achieve higher ratings, focus on social issues, participate in community development, and engage in philanthropy. At the same time, companies need to increase their focus on corporate governance, establish and improve internal control mechanisms, and strengthen communication and cooperation with shareholders and stakeholders. While uncertainties exist in the emergence of ESG rating divergence, the overall starting point is positive. Companies should think about longer-term development and make corresponding changes in management strategies according to market conditions. This includes promoting innovation in green management models and green

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technologies, and enhancing the performance evaluation and risk management systems of green management [8].

4.2.3. Building a Good Corporate Reputation

Table 1: Association between Corporate Reputation and ESG Performance

<table>
<tr><th>ESG Performance</th><th>Information Transmission</th><th>Information Reception</th><th>Effect</th><th rowspan="4">Corporate Reputation</th></tr>
<tr><td>Social Responsibility Report</td><td>Company Website/Social Media</td><td>Investors/Employees/Consumers</td><td>Enhance corporate reputation, increase investor trust, enhance employee belonging and loyalty.</td></tr>
<tr><td>Environmental Responsibility Activities (Sustainable Development/Environmental Innovation Products)</td><td>Charity Projects/Press Releases/Product Promotion</td><td>General Public/Media/Consumers/Industry Experts</td><td>Shape corporate environmental image, increase brand awareness, increase product sales, and gain public support and expert recognition.</td></tr>
<tr><td>Corporate governance policy</td><td>Government Communication /Industry alliance</td><td>Government officials /Enterprise personnel</td><td>Establish good government relations, strive for policy support, ensure compliance, and shape the image of industry leaders.</td></tr>
</table>

From previous years' data, companies with higher ESG ratings often have good corporate reputations. Additionally, companies with high ESG ratings benefit from better financing opportunities and significant capital market effects resulting from ESG information disclosure. Moreover, transitioning from "strategy" to "substance" on the basis of ESG is essential for building a good reputation [9] and improving ESG scores [10].

5. Conclusion

ESG rating discrepancies are a complex and multidimensional issue involving methodological differences among different rating agencies, variations in a company's own ESG performance, the influence of industry characteristics, and differences in investor understanding and application of ESG ratings. Firstly, in constructing rating models, different ESG rating agencies may exhibit significant differences. For instance, some agencies may emphasize the impact of environmental factors, while others may focus more on social and governance aspects. Additionally, divergences may arise in the selection of ESG evaluation indicators and the determination of weights by different rating agencies, directly leading to differences in rating results. This disparity necessitates investors to thoroughly understand the methodologies and evaluation criteria of each rating agency when selecting ESG ratings, in order to better comprehend and compare rating results and mitigate potential impacts on corporate reputation or management strategies due to rating discrepancies.

Secondly, a company's own ESG performance is also a significant factor contributing to rating discrepancies. There are considerable differences in companies' performance in environmental, social, and governance aspects, directly impacting the evaluation results by rating agencies. Some companies may excel in certain ESG areas while exhibiting deficiencies in others, leading to different rating outcomes from different rating agencies and consequently affecting corporate reputation and management strategies.

Moreover, industry characteristics (varied environmental, social, and governance challenges across different industries) also play a crucial role in ESG ratings. Therefore, companies in different industries may experience differences in ESG ratings. When comparing ESG ratings, investors need to take industry factors into full consideration to avoid being misled by rating discrepancies between different industries.

Lastly, investor understanding and application of ESG ratings also influence rating discrepancies. Variations may exist among investors in understanding and applying ESG ratings, leading to different perceptions and judgments on the same company's ESG ratings. Therefore, investors need to enhance their learning and understanding of ESG ratings to better apply them in investment decision-making, aiding companies in improving management strategies and enhancing corporate reputation.

In conclusion, ESG rating discrepancies are a complex and multidimensional phenomenon involving various factors. To mitigate the risks associated with ESG rating discrepancies, investors, rating agencies, and companies need to collaborate and communicate effectively, promoting the continuous improvement and development of the ESG rating system. Simultaneously, companies should enhance their reputation and continuously optimize management strategies based on their own circumstances and societal needs.

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