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ESG Performance and Long-Term Corporate Performance

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Abstract: With the global focus on climate change and sustainable development, the “dual carbon” targets—carbon peak and carbon neutrality—have become critical strategic objectives for many nations and corporations. As the world’s second-largest economy, China’s efforts in economic transformation and high-quality development play an essential role in achieving these targets. In this context, Environmental, Social, and Governance (ESG) factors have become a prominent topic in academic and business discussions. With growing awareness of ESG among investors and consumers, ESG considerations are now integral to corporate strategic planning. Research has shown that companies actively engaged in ESG initiatives tend to gain better market reputations, attract more investors and consumers, thereby reducing operational risks, enhancing overall corporate value, and improving competitiveness. Through a comprehensive review of existing literature and research, we find that ESG factors have a significant impact on corporate long-term sustainable development and investor interests.

Keywords: ESG performance, environment, performance, corporate value.

1. Introduction

ESG stands for Environmental, Social, and Governance. "Environmental" refers to the impact a company has on the environment through its operations, covering aspects like resource utilization, energy consumption, and emissions management. "Social" pertains to a company’s responsibilities and influence within society, including employee relations, community engagement, consumer rights, and human rights protection. "Governance" involves a company’s governance structure, decision-making mechanisms, transparency, and accountability policies.

In the context of today’s global economic development, ESG factors have become crucial in investment and corporate management. With the growing prominence of issues related to global climate change, social inequality, and corporate governance, a growing number of investors and companies are recognizing the impact of ESG factors on corporate performance.

Under the dual carbon target (carbon peaking and carbon neutrality), ESG factors have become even more significant. For both investors and companies, considering ESG factors has become a trend that helps reduce investment risks, improve long-term returns, and contribute positively to society and the environment. Within this dual carbon framework, ESG investment will become increasingly important and meaningful. Although various sectors are deepening research on ESG to align with

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national sustainability goals and corporate green development, there remains a lack of clarity around standardized rating systems for ESG in corporate performance. Additionally, the specific factors and outcomes of ESG's impact on long-term corporate financial performance are still not fully understood. In response, this paper examines previous research on ESG performance and corporate long-term financial performance. It provides an analysis and summary of the connotations and current state of ESG performance, the influencing factors of corporate ESG performance, and the relationship between ESG and corporate financial performance. Finally, it offers perspectives on future directions for ESG research and its future application in corporations.

2. The Connotation and Current State of Corporate ESG Performance

Corporate ESG performance was initially introduced by the United Nations Environment Programme (UNEP) in 2004, with a focus on non-financial information about companies. It represents a concept and practice that assesses a company's sustainable development capability and long-term value from multiple dimensions, drawing continuous attention from investors in the capital markets [1]. The philosophy of ESG responsibility investing originated from corporate social responsibility (CSR). Starting in the 1960s and 1970s, issues related to the sustainability of social and environmental resources began to gain widespread attention from the international community. However, it was not until 2004, when the United Nations Global Compact released the report "Who Cares Wins," that ESG emerged as an integrated concept in the public eye [2]. ESG practices in China began relatively late, but their development has been rapid. In recent years especially, both the government and society have shown a strong focus on the negative consequences of neglecting corporate social responsibility, and a series of policies has been introduced to promote ESG initiatives. Under policy guidance, publicly listed companies have become increasingly aware of the importance of disclosing ESG-related information proactively, and various sectors of society are paying more attention to non-profit activities and the performance metrics of corporate social responsibility. Domestic investors in China have also shown growing interest in the concept of ESG investing, initially with a focus on environmental protection and gradually expanding into social and governance aspects [3]. In summary, ESG aligns closely with China's green development agenda, goals for carbon peaking and carbon neutrality, modernization of governance, and the vision of building a shared future for humanity. The principles of ESG support sustainable development and facilitate green, low-carbon transformation for Chinese enterprises.

3. Factors Influencing Corporate ESG Performance

3.1. External Factors Affecting Corporations

Based on the PEST (Political, Economic, Social, and Technological) analysis framework, the external environment of a corporation, including political systems, economic development, social awareness, and technological theories, often first affects the effectiveness of ESG disclosures.

3.1.1. Political Systems

From the perspectives of institutional theory and legitimacy theory, external factors influencing ESG disclosures can be examined through three aspects: legal, labor, and cultural systems. On the legal system level, the strength of a country's legal framework concerning corporate social responsibility and the clarity of these laws play a critical role in determining the quality of a company's ESG disclosures. In countries with strong legal frameworks, corporations are more likely to proactively fulfill their social responsibilities and disclose ESG information, thus reducing instances of "greenwashing." The clarity of legal provisions influences how accurately companies interpret the

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laws and limits opportunities for loophole exploitation, curtailing corrupt practices and reducing profit-driven misconduct. In terms of labor systems, in countries with well-established labor regulations, companies are more likely to disclose ESG information to meet societal expectations regarding labor protection, leading to higher levels of ESG transparency. At the cultural level, corporations in countries with high or low levels of religious commitment tend to disclose ESG information more readily, reflecting the influence of cultural norms on corporate behavior.

3.1.2. Economic Development

In the current era, national economies have shifted from rapid growth to an emphasis on high-quality, sustainable growth. Prioritizing quality over mere economic gain reflects a growing commitment to the principle that "lucid waters and lush mountains are invaluable assets." This new economic paradigm encourages corporations to adopt more efficient and comprehensive ESG disclosures, aligning with national and societal development goals.

3.1.3. Social Awareness

With rising global temperatures and intensifying greenhouse effects, nations worldwide have ramped up their environmental policies. This shift has spurred governments and citizens alike to take proactive steps in promoting environmental stewardship. For example, in September 2023, the “Responsibility-Driven, Co-Creating the Future: 2022 Annual Chongqing Corporate Social Responsibility Case Studies Conference” was held, co-organized by the Chongqing Charity Federation and the Chongqing City Promotion Association, with the support of the Chongqing Municipal Publicity Department and hosted by Chongqing Daily Media Group. This event drew the enthusiastic participation of over 200 local companies and was widely publicized [4]. It demonstrated the commitment of exemplary companies to upholding social responsibility and making significant contributions to environmental protection. This momentum drives more corporations to deepen their engagement with ESG principles and improve information disclosure.

3.1.4. Technological Theory

Digitalization has become mainstream, and the digital economy is now a dominant trend, providing corporations with robust analytical and interactive capabilities. Digitalization also offers significant opportunities for improving ESG disclosures. Existing studies confirm that digital transformation can enhance corporate ESG performance. On the environmental front, digital transformation enables companies to improve production technology and efficiency, with a higher likelihood of investment in green innovation, thus enhancing environmental performance. Additionally, digital transformation allows companies to access a vast amount of information about leading industry players. To maintain competitive advantage and build a positive public image, companies are inclined to embrace green development principles, improve the quality of environmental disclosures, reduce resource consumption, and align with high-performance environmental benchmarks [5]. However, the ESG framework still faces challenges. There is no standardized format for ESG disclosures among publicly listed companies, leading to varying report quality and making it difficult for stakeholders to access information. Additionally, the lack of independence in third-party verification organizations exacerbates these issues, causing some companies to delay or avoid ESG disclosures altogether, thus reducing the overall volume of ESG information available.

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3.2. Internal Factors Affecting Corporations

Existing research has highlighted the impact of management characteristics and board characteristics on ESG information disclosure, analyzed as follows:

3.2.1. Management Characteristics

Compared to directly achieving economic benefits, ESG information disclosure evaluates a publicly listed company’s performance in environmental, social, and governance areas, helping it build a sustainable image and attract investment. This process, however, is indirect and long-term. Yet, the prevalence of short-termism, especially exacerbated by recent years of economic strain during the pandemic, has led managers to adopt short-sighted strategies to secure short-term profits to keep the company afloat, often ignoring the company’s environmental and social impact. Such practices often contradict the objectives of ESG information disclosure. Therefore, companies should link ESG practices with executive incentive structures, encouraging management to focus on ESG issues with a long-term perspective. Additionally, shortening executive tenure could mitigate the negative impact that extended tenures have on ESG disclosure, as longer-tenured managers may be more risk-averse and less inclined to disclose information to external stakeholders [6].

3.2.2. Board Characteristics

Traditionally, companies have been regarded as the primary participants in economic activities, with the core objective of maximizing shareholder value, reflecting their economic nature. However, if a company’s board can provide specialized knowledge to support ESG practices, this would lead to more professional and effective ESG disclosures. This approach ensures that companies can fulfill their responsibilities and enhance their reputation while maintaining profitability. Specifically, larger board sizes [7] and higher board meeting frequencies [8] provide companies with more critical resources, promoting improved levels of ESG disclosure. According to stakeholder theory, companies with greater board independence, a higher proportion of female directors, and a dedicated corporate social responsibility (CSR) committee tend to demonstrate higher levels of ESG information disclosure [9].

In summary, both external and internal factors affecting ESG information disclosure generally have a positive influence, reflecting the growing importance of ESG practices. As the ESG trend strengthens, companies should enhance their governance standards, improve ESG information transparency, and fulfill their social responsibilities.

4. ESG Performance and Long-Term Corporate Performance

4.1. ESG Performance and Corporate Cost Control

By improving ESG performance, companies can signal high-quality development to both internal and external stakeholders, alleviating "moral hazard" and "adverse selection" issues arising from information asymmetry. This, in turn, enhances stakeholder trust, reinforces corporate legitimacy, increases reputational capital, and ultimately influences debt financing costs through stakeholder behaviors. Among various stakeholders critical to corporate development, creditors, suppliers, consumers, government entities, and employees are especially susceptible to the effects of information asymmetry, which can directly or indirectly impact a company’s debt financing costs.

First, strong ESG performance helps convey a signal of high-quality development to creditors, reducing the risk premium they demand, thus directly lowering debt financing costs. Creditors typically assert their rights in two ways: explicit claims and implicit claims on corporate resources.

If a company's ESG performance is poor, creditors may, under implicit claims to protect their rights, question the company's debt repayment ability and demand higher default costs and higher interest rates. Conversely, positive performance in environmental protection, social responsibility, and governance helps establish a favorable debtor image, allowing companies to negotiate lower interest rates and more flexible loan terms with creditors [10].

Good ESG performance also signals high-quality development to consumers and suppliers. By strengthening customer loyalty and increasing sales revenue, as well as stabilizing supplier relationships and reducing costs, companies can improve operating profits, which indirectly lowers debt financing costs. Rational consumers and suppliers, motivated by both maximizing their benefits and a sense of social responsibility, are more inclined to engage with companies that meet green development standards, proactively undertake social responsibilities, and have minimal negative publicity.

Moreover, sound ESG performance aids in building positive government relations, garnering governmental support, and increasing non-operating income, which reduces the need for debt financing and indirectly lowers financing costs. In a socialist market economy, the "visible hand" of government plays a significant role in the allocation of resources, particularly financial resources. Strong ESG performance, reflecting a company's commitment to green development and social responsibility, aligns with the shift from rapid to high-quality economic growth, enabling companies to secure more favorable tax breaks and loan conditions from the government [11], and facilitating access to essential resources.

Additionally, companies with strong ESG performance can signal high-quality development to employees, boosting their identification with corporate values, reducing cash outflows related to human resources, and lowering operating costs, which decreases the need for debt financing and indirectly reduces financing costs.

Furthermore, companies with good ESG performance enjoy a better reputation in the job market, which helps them attract top talent at a lower cost. Therefore, a company's strong ESG performance mitigates information asymmetry with both internal and external stakeholders, signaling trustworthiness to creditors, consumers, suppliers, government, and employees alike. This trustworthiness leads to reduced costs of capital usage and lower debt financing needs, ultimately decreasing the company's debt financing costs [12].

4.2. ESG Performance and Corporate Capital Efficiency

There is a strong relationship between ESG and corporate long-term profitability. ESG factors not only impact a company's reputation and brand image but also significantly affect operational efficiency and long-term growth potential. Recent studies have shown that companies with high ESG ratings can achieve additional ESG-related benefits. Furthermore, higher ESG performance is associated with better financial outcomes, including higher valuations, lower risk, and increased profitability, along with higher stock values (higher collateral values) and more favorable returns on mergers and acquisitions [13].

Firstly, companies need to address environmental issues, including resource utilization, pollution reduction, and sustainable development. By implementing eco-friendly practices and promoting green production, companies can lower environmental risks, reduce environmental costs, and improve resource efficiency. This supports stable operations and profitability over the long term.

Secondly, in the social dimension, companies should focus on employee well-being, social responsibility, and community engagement. Prioritizing employee welfare, training, and career development enhances employee satisfaction and loyalty. Additionally, actively fulfilling social responsibilities, such as participating in public welfare and charitable activities, helps build a positive social image, increasing brand value and attractiveness, and ultimately improving long-term profitability.

Thirdly, the governance dimension involves internal management and decision-making mechanisms. Companies should establish robust governance structures to ensure transparency and informed decision-making. Additionally, companies should strengthen risk management by implementing risk assessment and response mechanisms to adapt to market changes and uncertainties, thereby enhancing stability and resilience to support long-term profitability.

In examining the impact of ESG performance on corporate profitability, factors such as company size, nature, and industry type may influence the effect. Regarding company size, according to economies of scale theory, small- to medium-sized enterprises (SMEs) may lower average costs by expanding operations to enhance profitability. Unlike large enterprises, SMEs might avoid costly environmental, social responsibility, and governance initiatives, focusing instead on product innovation and brand development. Thus, the effect of ESG performance on profitability is generally less significant for SMEs than for large companies. In terms of industry type, studies indicate that enhanced ESG disclosures can increase value for companies in high-pollution industries. However, due to the substantial costs associated with ESG improvements, particularly in high-pollution sectors, the profitability boost may not be significant [14].

In conclusion, ESG factors have a significant impact on corporate long-term profitability. Companies should proactively address ESG issues and incorporate them into strategic planning and daily management. Through continuous improvement and innovation, companies can maintain stable profitability and competitive advantages over the long term.

4.3. ESG Performance and Corporate Risk Control

First, proactively disclosing ESG-related information helps improve corporate transparency. Market risk stems from fluctuations in interest rates, exchange rates, stock prices, and bond values. Publicly listed companies are inherently affected by market uncertainties, and according to signaling theory, market risk primarily arises from information asymmetry between companies and investors [15]. ESG disclosure enhances transparency by providing reliable information about a company’s environmental, social, and governance practices. By sharing this information, companies can reduce information asymmetry with stakeholders, strengthen trust, and mitigate risks associated with uncertainty and information gaps [16]. Transparent disclosure of environmental, social, and governance information enables internal and external stakeholders to better understand a company's performance and risks, thereby reducing uncertainty linked to information asymmetry and contributing to lower operational risk. ESG disclosure helps companies build trust with stakeholders (including shareholders, employees, customers, and suppliers), demonstrating their commitment to balancing various interests, which enhances stakeholder trust and fosters long-term, stable partnerships. Reduced information asymmetry between companies and investors also increases investor understanding, guiding them to make well-informed decisions [17].

Second, proactive ESG disclosures allow companies to adjust their operational strategies and enhance internal governance. For companies aspiring to be world-class, elevating ESG principles to a strategic level is essential, integrating ESG management into governance structures, management approaches, and even business models [18]. By transparently disclosing ESG data, companies can improve decision-making transparency and quality, strengthen internal oversight and control mechanisms, standardize corporate behavior, and prevent potential risks and misconduct. Furthermore, ESG disclosure can help companies identify business opportunities, such as improvements in energy efficiency, development of innovative products and services, and investments in social responsibility. Through analyzing and disclosing ESG information, companies gain insights into market demands and trends, enabling strategic planning that enhances competitiveness and innovation capabilities.

5. Conclusion

5.1. Limitations

Standardization and Perceptual Differences: Currently, there is a lack of globally standardized ESG assessment criteria, resulting in differences in understanding and evaluation methods among institutions and investors when assessing corporate ESG performance. This discrepancy affects the consistency of investment decisions.

Data Quality and Reliability: ESG data often suffers from quality and reliability issues. Some data may be incomplete or inaccurate, increasing data heterogeneity and limiting investors' ability to effectively evaluate and compare ESG factors.

Relationship Between ESG and Financial Performance: Although some studies suggest that strong performance in environmental, social, and governance aspects may positively impact financial performance, other studies question this linkage, leading some investors to approach ESG investments cautiously due to uncertainties about potential returns and risks.

5.2. Conclusion

Strengthening ESG Data and Assessment Standards: It is essential to promote the establishment of standardized ESG assessment criteria and data disclosure requirements to enhance the quality and comparability of ESG data and increase investor trust in ESG information. Improving data quality and comparability is critical, as is reinforcing mechanisms for data verification and auditing. Independent third-party organizations should be encouraged to validate and audit corporate ESG data.

Deepening Research on ESG and Financial Performance: Given the ongoing development of ESG principles and the increasing availability of data, more empirical research on responsible ESG investing is needed to expand current research perspectives [19]. Future studies should investigate the mechanisms through which ESG factors impact corporate financial performance and long-term value creation, exploring the return and risk characteristics of ESG investments to provide investors with more compelling insights.

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