ISSN 2959-6130

Environmental, Social and Governance (ESG) Development Status and Outlook

Xunzhuo Gong

Chuzhou Middle School, Chuzhou, Anhui, 239054, China
Email: cfyzmotor@163.com

Abstract:

In recent years, environmental, social and governance (ESG) factors have been increasingly emphasized by investors and corporations. ESG refers to the environmental, social and governance performance of a corporation, reflecting its long-term development potential and sustainability. This paper summarizes the current state of research on ESG development in the industry and academia, and provides an outlook on the future development of ESG. It is found that ESG development in the real world has problems such as insufficient corporate cognition of ESG management, lack of uniform standards for ESG rating system, unsolicited and unstandardized corporate ESG disclosure, and lagging development of ESG investment. Academic ESG research mainly focuses on the study of the relationship between ESG performance and financial performance, the study of the relationship between ESG performance and enterprise value, and the study of the relationship between ESG performance and financing costs and financing constraints. In the future, ESG development should focus on improving the cognitive level of enterprises on ESG management, promoting the unification and standardization of ESG rating system, encouraging enterprises to disclose ESG information proactively and in a standardized manner, enriching ESG investment products and services, and expanding the scale of ESG investment.

Keywords: ESG, sustainability, corporate social responsibility, investment; financial performance

1. Introduction

With the development of global economy and society, environmental pollution, social injustice, and corporate governance issues are becoming more and more prominent, and the traditional financial index-oriented investment concept is gradually being questioned. The ESG investment concept believes that the ESG performance of enterprises is an important factor for their long-term development, and investors should comprehensively consider the enterprise's financial performance and ESG performance when making investment decisions. The rise of the ESG investment concept has promoted the rapid development of ESG research. Scholars have studied ESG from different perspectives and achieved fruitful results. However, there are still some gaps in ESG research, such as: the existing research on the relationship between ESG performance and financial performance has not yet reached a consistent conclusion, and the influence mechanism needs to be further explored; the influence mechanism of ESG performance on enterprise value still needs to be studied in depth; the application of ESG factors in investment decision-making is still insufficient, and there is a lack of systematic and effective ESG investment evaluation methods. Aiming at the above research gaps, this paper aims to explore the current research status of ESG development in the industry and academia, and to look forward to the future development of ESG. The specific research objectives are as follows: to sort out the current situation of ESG development in the industry and analyze the existing problems and challenges; to summarize the progress of ESG research in the academia and summarize the main research results and research directions; and to look forward to the future development trend of ESG, and to put forward the policy recommendations and practical paths. This paper provides a comprehensive literature review for ESG research and practice.

2. The current state of research on ESG development in industry

2.1 Insufficient corporate awareness of ESG management

In recent years, environmental, social, and governance (ESG) factors have been increasingly emphasized by investors and companies. However, the level of understanding of ESG management in the industry is still uneven, and in general, the following problems exist: First, there is a lack of deep understanding. Some companies regard ESG as a mere formalism or icing on the cake, failing to fully realize the significance of ESG management to the long-term development strategy of enterprises. Second, insufficient strategic integration: ESG management needs to be integrated with the overall business strategy of the enterprise to maximize its effectiveness. However, many companies have not fully integrated ESG into their strategies, resulting in a superficial approach to ESG management. Third, a lack of professional talents: ESG management involves multiple fields such as environment, society, and governance, and requires specialized knowledge and skills. However, many companies lack ESG management talents, making it difficult to effectively implement ESG management.

2.2 Lack of harmonization of ESG rating systems

Currently, there are multiple ESG rating agencies around the world, such as MSCI, Sustainalytics, RobecoSAM, etc.. Each of these agencies has developed different ESG rating standards and methodologies, leading to differences in corporate ESG rating results and making it difficult for investors to compare the ESG performance of different companies. First, the indicator system is inconsistent. There are differences in the ESG evaluation indicators selected by different rating agencies, making it difficult to compare the rating results. Second, the rating methods are diverse. Different rating agencies have different scoring methods for ESG indicators, leading to bias in the rating results. Third, different weight settings. There are differences in the weight settings of different rating agencies for each ESG indicator, leading to different rating results.

2.3 Corporate ESG information disclosure is not proactive and standardized

First, disclosure is not proactive. Enterprises fail to recognize the importance of ESG information disclosure, considering it just a routine matter rather than a key aspect of enterprise operations. Enterprises lack a comprehensive ESG information disclosure management system and process, leading to confusion and disorder in ESG information disclosure. ESG information covers a wide range of aspects, and some enterprises struggle to effectively collect and integrate relevant information, resulting in untimely and inaccurate ESG information disclosure. Second, the quality of disclosure is not standardized. The disclosure of corporate ESG information is incomplete and does not fully reflect the ESG performance of the enterprise. For example, only some ESG indicators are disclosed, or important ESG information is omitted. Inconsistency in the quality of corporate ESG information disclosure makes it difficult to compare the information. For instance, using different definitions or calculation methods for ESG indicators, or disclosing the same indicators in varying ways. Enterprises have misrepresented their ESG disclosures in order to enhance their ESG ratings or attract investors. Third, comparability is poor. Currently, there is no universal ESG disclosure standard globally, and there are differences in the requirements for ESG disclosure across countries and regions. The format of corporate ESG disclosure is not uniform, making it difficult for investors to compare the ESG performance of different companies. Additionally, there are differences in the content of corporate ESG disclosure, such as the ESG indicators disclosed and the scope of disclosure, further hindering information comparability.

2.4 Lagging development of ESG investments

First, the scale of products is limited. ESG investment concepts emerged in the 1990s, and the development time is relatively short compared to traditional investment concepts. ESG investment products need to comprehensively consider the financial performance and ESG performance of enterprises, and it is more difficult to develop. Currently, global ESG investment indexes and benchmarks are not perfect, making it difficult for investors to choose suitable ESG investment products. Second, low investor awareness: the concept of ESG investment has not yet been popularized globally, and many investors lack understanding of ESG investment. Many investors lack ESG investment-related knowledge and skills, making it difficult to conduct effective ESG investment analysis. ESG investment has certain risks, and some investors have insufficient knowledge of ESG investment risks. Third, research support is insufficient. ESG investment theory research is still in its infancy and lacks a perfect theoretical system. lack of practical experience in ESG investment makes it difficult for investors to find effective ESG investment strategies. Lack of ESG investment-related data makes it difficult for investors to conduct effective ESG investment research.

3. Current status of research on ESG development in academia

3.1 Study on the relationship between ESG performance and financial performance

In recent years, with the rise of the concept of sustainable development, ESG (Environmental, Social and Governance) issues have gradually become the focus of attention in both academia and the industry.ESG research mainly focuses on the following aspects:

3.1.1 ESG performance is positively correlated with financial performance

Numerous empirical studies have shown that there is a positive correlation between ESG performance and financial performance, i.e., firms with good ESG performance tend to have higher financial performance. First, risk reduction. Good ESG performance can help enterprises reduce business risks, for example, good environmental management can reduce the risk of environmental pollution, good social responsibility can enhance corporate reputation and reduce the risk of legal disputes arising from social issues, and good governance structure can improve the operational efficiency and decision-making quality of enterprises. Second, enhance reputation. Good ESG performance can enhance corporate reputation and brand image, attract more investors and customers, and thus improve corporate profitability. Finally, get policy support. Some governments will provide policy support to enterprises with good ESG performance, such as tax incentives, financing facilities, etc., so as to reduce the operating costs of enterprises and improve their profitability.

3.1.2 ESG performance is negatively correlated with financial performance

Some studies have found a negative correlation between ESG performance and financial performance, i.e., firms with good ESG performance tend to have lower financial performance. First, short-term costs increase.ESG investment often requires companies to invest certain costs in the short term, for example, environmental protection governance, employee welfare improvement, etc., and these costs will reduce the short-term profitability of the company. Second, the market response lags. There is a certain lag in the market's value discovery mechanism, and it may take a long time for investors to recognize the value of ESG performance, resulting in the poor stock price performance of companies with good ESG performance in the short term. Finally, research methodology and sample selection bias. Some studies may have methodology and sample selection bias, leading to inconsistent findings.

3.2 Research on the relationship between ESG performance and firm value

Research has shown that companies with good ESG performance tend to have higher enterprise value.Companies with good ESG performance can reduce business risks, improve their reputation and brand image, attract more investors and customers, and ultimately increase the value of the company.ESG performance can increase enterprise value through the following ways: first, lowering the cost of financing for the company.Companies with good ESG performance tend to have lower financing costs because investors perceive them as having a lower risk of default. First, lower financing costs. Companies with good ESG performance tend to have lower financing costs because investors perceive them as having a lower risk of default. Second, attracting more investors. companies with good ESG performance are more likely to attract investors, especially those who focus on ESG factors. Third, it improves the operational efficiency of firms. Good ESG performance can improve the operational efficiency of enterprises, for example, good environmental management can improve the efficiency of resource utilization, and good employee relations can improve the efficiency of employee work.

3.3 ESG performance and financing costs, financing constraints

Research shows that firms with good ESG performance tend to have lower financing costs and financing constraints.Firms with good ESG performance can reduce the default risk of firms and enhance investor confidence, thus obtaining lower financing costs and more lenient financing conditions.ESG performance can reduce the financing costs and financing constraints of firms through the following ways: first, reduce the default risk of firms. Good ESG performance can reduce the default risk of enterprises because investors perceive these enterprises as more soundly run and more transparently managed. Second, enhance investor confidence. Good ESG performance can improve investor confidence because investors believe that these companies are more trustworthy and more likely to repay their debts. Third, improve the financing environment: enterprises with good ESG performance are more likely to receive support from the government and financial institutions, thus improving the financing environment for enterprises.

4. Conclusion

ESG is an important cornerstone of corporate sustainable development, which has been increasingly emphasized by academics. Academic research on ESG has achieved fruitful results, providing an important theoretical basis for the practice and development of ESG. In the future, ESG will be more widely applied and play a more important role in promoting sustainable economic and social development.

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