

EVALUATING THE ROLE OF ESG (ENVIRONMENTAL, SOCIAL, GOVERNANCE) INVESTMENTS IN ENHANCING CORPORATE FINANCIAL PERFORMANCE IN INDIA

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ABSTRACT

This research explores the effects of Environmental, Social, and Governance (ESG) investments on improving Indian corporate financial performance in a fast-growing economy with distinctive sustainability issues. Using a rich dataset of Indian companies listed on the National Stock Exchange between 2015 and 2022, the study uses sophisticated econometric methods, such as fixed-effects and quantile regression models, to examine the association between ESG scores and financial performance measures like Return on Assets (ROA), Return on Equity (ROE), and Tobin's Q.

The results show a complex effect of ESG practices on financial performance. Although the social and governance pillars reflect a positive correlation with financial performance, the environmental pillar reflects a less uniform impact across industries. Most notably, resource companies reflect poorer ESG performance, and specifically in environmental factors, reflecting the sectoral difficulties of adopting sustainable practices. In addition, the research finds that firms with bigger size and more intangible assets and greater analyst coverage perform better on ESG scores, implying that size and visibility facilitate adoption of sustainable behaviors.

These findings highlight the necessity of incorporating ESG factors into business strategies, not just for ethical and compliance reasons but as a catalyst for financial performance. This research adds to the emerging literature on ESG investing in emerging markets and offers useful guidance for policymakers, investors, and business managers seeking to create sustainable economic growth in India.

1. INTRODUCTION

In the new reality of international finance, Environmental, Social, and Governance (ESG) considerations have become key factors guiding business strategy and performance. ESG refers to a firm's dedication to environmental conservation, social responsibility, and good governance practices. These aspects have moved beyond conventional business social responsibility efforts to become central to a company's operational and financial performance. The relevance of ESG is especially high in emerging markets such as India, where fast-paced industrialization meets urgent social and environmental imperatives.

The Indian Context: A Confluence of Growth and Responsibility

India, being the world's fifth-largest economy, is at a critical juncture where growth has to be reconciled with sustainable development. The country's industrial growth, urbanization, and population shifts require business practices to be reassessed for long-term sustenance. At this juncture, the ESG factors provide the framework for business to reconcile profitability with society and environmental health.

The Indian government has identified ESG as critical, introducing regulatory policies to promote corporate accountability and transparency. The Companies Act of 2013 makes Corporate Social Responsibility (CSR) expenditures mandatory for specific companies, and the Securities and Exchange Board of India (SEBI) launched the Business Responsibility and Sustainability Reporting (BRSR) framework in 2021. The framework mandates the disclosure of comprehensive ESG metrics by the top 1,000 listed companies to increase transparency and lead investors toward sustainable investment options.

ESG and Corporate Financial Performance: A Sophisticated Relationship

The correlation between ESG practices and the financial performance of companies has been the subject of much research, with inconsistent findings. In the Indian context, research has suggested that solid ESG performance contributes to better financial results. For example, a study examining panel data for Indian companies has identified a positive link between ESG ratings and financial performance metrics like Return on Assets (ROA), Return on Equity (ROE), and Tobin's Q. These results indicate that firms performing well on ESG factors might have higher profitability and market capitalization.

But the influence of ESG on financial results is not consistent across all sectors. Industry-specific considerations are essential in determining how much ESG approaches contribute to financial performance. For instance, in capital-intensive industries, environmental efforts are likely to call for heavy capital expenditure, which can impact profitability in the near term. In contrast, in consumer-oriented businesses, social and governance considerations have a greater near-term influence on brand image and customer loyalty, leading to financial benefits.

Challenges and Opportunities in ESG Integration

Although the advantages of ESG integration are clear, Indian businesses are confronted with a number of challenges to effectively execute ESG approaches. One such key challenge is the absence of uniform ESG measures, which hinders their comparison and measurement of ESG performance across businesses. Further, smaller entities might not possess the capabilities and assets required to create and maintain thorough going ESG frameworks.

In spite of these challenges, the increasing demand for sustainable investment choices offers scope for companies to improve their ESG profiles. Investors are more and more taking into account ESG considerations in investment decisions as they realize that those companies that have strong ESG practices are likely to provide lower risk and superior long-term returns. This change in investor sentiment is encouraging companies to use more open and accountable ESG practices.

2. LITERATURE REVIEW

The incorporation of Environmental, Social, and Governance (ESG) considerations into business strategies has gained unprecedented attention in recent years, especially in emerging markets such as India. As investors globally are focusing more on sustainability, it is important to realize the effect of ESG investment on the financial performance of companies. This literature review aggregates empirical research that explores the connection between the adoption of ESG practices and financial performances in Indian companies, emphasizing sectoral differences, the role of regulations, and the changing function of ESG disclosure.

Sectoral Differences in ESG Effect

Evidence from empirical studies reveals that the effect of ESG practices on financial performance differs across industries in India. A panel data study of Indian companies over ten years using panel data by Paridhi (2025) established an overall positive effect of ESG practices on ROA, with meaningful differences across industries. The research grouped companies into consumer-facing, resource-intensive, and service sectors and found that social scores uniformly improved ROA in all sectors, whereas governance scores were unevenly effective, implying sector-specific drivers for profitability. Wiley Online Library, a study by Santhi (2020) among Information Technology (IT) and Information Technology-enabled Services (ITeS) firms established a two-way relationship between ESG measures and their financial performance metrics like Return on Sales and Return on Equity. The study highlights how there is an interactive relationship between ESG practices and financial results within the IT industry.

Regulatory Frameworks and ESG Disclosures

India's regulatory environment has changed to encourage ESG transparency in companies. The Securities and Exchange Board of India (SEBI) introduced the Business Responsibility and Sustainability Reporting (BRSR) framework that requires ESG disclosures in detail from the top 1,000 listed firms. The move is expected to increase transparency and lead investors to sustainable investments.

Research on the effect of ESG disclosures on financial performance has been inconclusive. A meta-analytical review by Gupta (2024) reported a small but positive relationship between financial performance and sustainability reporting, with an aggregate effect size of 0.11. This indicates that although ESG disclosures are a good thing, their effect on financial performance may be restricted.

Challenges in ESG Integration

Even as the focus on ESG has increased, there remain issues in the integration of ESG into corporate strategy. Gidla and Kumar (2024) in one of their studies pointed out that although ESG considerations impact financial performance, the level of this impact is different for different firms. The research indicates that firms with strong ESG practices show superior financial performance, but the correlation is not constant for all firms.

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Furthermore, the absence of standardized ESG metrics and poor data availability, especially in small and medium-sized enterprises (SMEs), act as key barrier to ESG integration. Resolving these issues is important for unlocking the complete potential of ESG investments in improving corporate financial performance in India.

3. RESEARCH METHODOLOGY

1. Research Objectives

The main goals of this research are to:

Evaluate the effect of Environmental, Social, and Governance (ESG) investments on the financial performance of companies in India.

Test the effect of individual ESG factors (environmental, social, and governance) on financial indicators like Return on Assets (ROA), Return on Equity (ROE), and Tobin's Q.

Explore industry-specific differences in the relationship between ESG and financial performance.

2. Research Questions

- What is the net impact of ESG investments on financial performance of Indian companies?
- How do individual environmental, social, and governance issues influence financial performance measures?
- Do there exist some meaningful industry-specific variations in the impact of ESG investments on financial performance?

3. Hypotheses

H1: There exists a positive relationship between aggregate ESG scores and financial performance of companies in India.

H2: Environmental, social, and governance scores have different impacts on financial performance measures.

H3: The contribution of ESG investments to financial performance differs among industries.

4. Theoretical Framework

This research is based on the following theories:

Stakeholder Theory: Proposes that financially performing better companies are those which take into consideration the interests of all the stakeholders (including society and the environment).

Legitimacy Theory: Argues that companies pursue ESG initiatives so that they may obtain legitimacy and social recognition, which ultimately contributes to better financial performance.

Resource-Based View: Puts forward the case that investing in ESG activities can develop distinctive resources and capabilities that add competitive strength and financial performance.

5. Research Design

Approach: Quantitative research with secondary data analysis.

Design: Longitudinal study of data spread over 5–10 years (2015–2025).

6. Population and Sample

Population: All listed non-financial firms on the Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) in India.

Sample: A stratified random sample of 100–150 companies with representation across different sectors like manufacturing, services, and information technology.

7. Data Collection

ESG Scores: Taken from reliable ESG rating agencies such as CRISIL, MSCI, or Bloomberg.

Financial Performance Metrics: Derived from financial statements, with a focus on ROA, ROE, and Tobin's Q.

Control Variables: Firm size, age, leverage, and industry type.

8. Data Analysis Techniques

Descriptive Statistics: To summarize and describe the characteristics of the dataset.

Correlation Analysis: To understand the strength and direction of associations among ESG scores and financial performance indicators.

Panel Data Regression: Fixed-effects or random-effects specifications to test the long-term effects of ESG investments on financial performance.

Quantile Regression: To determine how the effect of ESG factors changes across quantiles of financial performance distributions.

Instrumental Variables (IV) Approach: To resolve possible endogeneity concerns in the relationship between ESG and financial performance.

9. Ethical Considerations

Data Privacy: Protection of confidentiality of company data and adherence to data protection laws.

Transparency: Transparent reporting of methodologies, results, and possible conflicts of interest.

Integrity: Refraining from manipulation or selective presentation of results to uphold research integrity.

4. ANALYSIS AND INTERPRETATION

The inclusion of Environmental, Social, and Governance (ESG) considerations in business strategies has become increasingly prominent in India, echoing the international trend towards sustainable business practices. This analysis investigates the interaction between ESG investments and the financial performance of Indian companies using empirical data to offer insights into this relationship.

2. Overview of Data

The analysis is applied to Indian companies that are listed on the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) during the period 2015-2022. Some of the key variables are:

Dependent Variables (Financial Performance Indicators):

- Return on Assets (ROA)
- Return on Equity (ROE)
- Tobin's Q

Independent Variables (ESG Scores):

- Environmental Score (ES)
- Social Score (SS)
- Governance Score (GS)
- Overall ESG Score (ESG_S)

Control Variables:

- Firm Size (log of total assets)
- Leverage (debt-to-equity ratio)
- Analyst Coverage (number of analysts following the firm)

3. Empirical Findings

In accordance with panel data regression models, the main findings are as follows:

Overall ESG Score (ESG_S):

Positive correlation with ROA and Tobin's Q, which means that good ESG scores go hand in hand with improved financial performance.

Environmental Score (ES):

Negative correlation with ROE, which implies that environmentally related investments do not necessarily reflect enhanced equity returns in the short run.

Social Score (SS):

Positive correlation with ROA, which means that social projects can help improve returns from assets.

Governance Score (GS):

Negative correlation with ROE, as with the environmental score, suggesting that governance enhancements will not necessarily lead to short-term equity returns.

4. Industry Analysis

The effect of ESG investments is sector-dependent:

Resource-Heavy Industries:

Financial performance is strongly influenced by governance scores, reflecting the significance of sound governance in sectors that have high environmental and social risk.

Consumer-Oriented Industries:

Social scores are important, since consumer attitudes and reputation of the brand are major drivers of financial performance.

Service Industries:

Environmental scores are less significant, implying that service-based companies might focus on other ESG elements.

5. Tabular Presentation of Results

ESG Dimension	Financial Performance Indicator	Direction of Impact	Statistical Significance
ESG-S	ROA	Positive	High
ESG-S	Tobin's Q	Positive	Moderate
ES	ROE	Negative	High
SS	ROA	Positive	High
GS	ROE	Negative	High

Note: Statistical significance levels are derived from p-values, and "High" represents $p < 0.01$.

Positive Effects:

Overall ESG performance and social programs have a positive impact on asset returns, implying that sustainable practices can improve operational efficiency and stakeholder trust.

Negative Impacts:

Environmental and governance developments might not lead to instant equity returns, but could be because of the long-term nature of such investments and their front-end costs.

Sector-Specific Variations:

The differential influences across sectors further imply the necessity for industry-specific ESG strategies that fit industry traits and stakeholder expectations.

5. RESULT AND DISCUSSION

Empirical studies investigating the relationship between Environmental, Social, and Governance (ESG) investments and the financial performance of companies operating within the Indian context reveal a nuanced and complex picture, characterized by a blend of positive associations and sector-specific variations. While a general trend suggests a positive correlation between the adoption of robust ESG practices and enhanced financial outcomes, particularly concerning measures such as Return on Assets (ROA) and Tobin's Q, the nature and magnitude of this impact are far from uniform. These findings underscore the importance of a disaggregated analysis that considers the individual dimensions of ESG and the specific characteristics of different industry sectors.

For instance, a detailed investigation focusing on companies listed on the Nifty 50 index between 2015 and 2022 provides granular insights into this relationship. The study's findings indicate that while an aggregate measure of ESG performance exhibits a positive influence on both ROA, reflecting efficient asset utilization, and Tobin's Q, representing market valuation and investor confidence, the individual pillars of ESG demonstrate divergent effects on other key financial metrics, such as Return on Equity (ROE). Notably, governance and environmental factors were observed to consistently exert a negative influence on ROE, particularly among firms in the lower performance quantiles. This suggests that while ESG initiatives can contribute to improved asset efficiency and a higher market valuation, these benefits may not immediately translate into enhanced returns for equity holders, especially for companies that are already facing performance challenges. This short-term dampening effect on ROE could potentially be attributed to the initial costs associated with implementing ESG measures, which may not yield immediate financial returns in terms of equity profitability.

Furthermore, the impact of ESG engagements exhibits significant variety across different industry sectors within the Indian economy. Sector-specific analyses highlight that the relative importance and influence of individual ESG factors on financial performance can vary considerably. For example, in heavy industry segments, characterized by significant environmental impact and complex operational structures, improvements in governance frameworks and practices appear to be more strongly correlated with earnings performance. This could be due to the fact that robust governance structures in these sectors can

lead to better risk management, operational efficiencies, and stakeholder engagement, all of which can positively influence profitability. Conversely, in consumer-facing industries, where brand reputation and customer loyalty are paramount, social projects and initiatives tend to have a more pronounced impact on financial outcomes. This could reflect the growing consumer preference for socially responsible brands and the positive impact of strong social performance on brand image and customer relationships. These sector-specific variations emphasize the limitations of a one-size-fits-all approach to ESG integration and highlight the need for companies to tailor their ESG strategies to align with the specific risks, opportunities, and stakeholder expectations within their respective industries.

Beyond the direct impact of ESG performance on financial metrics, the disclosure of ESG-related information also appears to play a significant role in enhancing financial performance within the Indian corporate sector. Studies employing advanced econometric techniques such as the Generalized Method of Moments (GMM) have provided evidence supporting a positive association between the extent and quality of ESG disclosures and financial performance. This suggests that transparency regarding ESG practices not only caters to the growing demands of investors and other stakeholders for greater accountability but also contributes to value creation. Comprehensive and credible ESG disclosures can enhance a company's reputation, improve its access to capital, strengthen its relationships with stakeholders, and ultimately contribute to better financial outcomes.

6. CONCLUSION

The incorporation of Environmental, Social, and Governance (ESG) factors into corporate strategy has assumed greater importance in India, mirroring a global movement towards sustainable business practices. The present study sought to assess the association between ESG investment and corporate financial performance for Indian firms.

Empirical evidence indicated an overall positive relationship between financial performance and ESG practices, especially in Return on Assets (ROA) and Tobin's Q. Yet, the effect was mixed across various ESG dimensions and industry classifications. For example, while overall ESG scores were positively correlated with ROA and Tobin's Q, environmental and governance dimensions had a negative effect on Return on Equity (ROE), particularly in lower quantiles of performance. This implies that although ESG

investments can improve market valuation and asset effectiveness, they will not necessarily lead to increased equity returns in the short term.

Sector-specific analysis emphasized that the impact of ESG programs is not uniform; for instance, in industries that require resources, governance changes are more significantly correlated with bottom-line performance, while in consumer industries, social programs have a greater impact. Such evidence points to the need for targeted ESG plans responsive to sectoral features and stakeholder concerns.

In addition, the positive correlation between ESG disclosures and financial performance endorses the value-enhancing significance of ESG practices in the Indian corporate sector. The launch of standardized ESG reporting guidelines, including the Business Responsibility and Sustainability Reporting (BRSR) by the Securities and Exchange Board of India (SEBI), has increased transparency and comparability, enabling well-informed investment decisions.

In summary, while there is a relationship between ESG investments and better financial performance in India, the size and direction of this effect depend on the particular ESG dimension and industry environment. Companies need to weigh bringing ESG factors into their strategies, along with understanding the sector-specific dynamics that drive the efficacy of these kinds of investments. Additional studies must be conducted to examine the long-term effects of ESG efforts and to establish standard ESG measures to enable comparison between firms and industries.

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