The Impact of ESG Performance on the Firm Valuation

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Abstract. ESG, an acronym for environmental, social, and corporate governance, represents a framework for assessing the sustainability and societal impact of enterprises. The environmental dimension evaluates how businesses affect and manage their relationship with the natural environment, while the social dimension emphasizes their influence and responsibilities toward society. Corporate governance, on the other hand, examines the internal management structures and decision-making mechanisms that guide enterprises. In recent years, crises such as the COVID-19 pandemic have underscored the importance of businesses adopting greater social responsibility. As a result, the evaluation of companies through an ESG lens has gained prominence, offering a pathway for enterprises to optimize their industrial structures while contributing to the broader connotations of sustainable development. Furthermore, the rising importance of green finance has accelerated the development and integration of ESG principles worldwide. As a critical component of the green finance ecosystem, ESG not only serves as a tool for corporate performance evaluation but also plays a pivotal role in driving the global transition toward sustainable economic practices.

Keywords: Sustainable Development; Green Finance; Corporate Social Responsibility.

1. Introduction

There are three main reasons for the rise of ESG at home and abroad. First of all, in the 1980s, sustainable development gradually became the consensus of global development. This theory emphasizes that enterprises, as the main body of economic activities, should pay attention to the impact on society and environment while pursuing economic benefits, so as to achieve long-term sustainable development, providing theoretical support for the rise of ESG. The second is the promotion of international organizations, with the United Nations providing an important role in the emergence of the ESG concept. The Finance Initiative was launched at the Earth Summit in Rio de Janeiro in 1992 and the Global Compact in 2000, which provides the principles and framework for ESG. Finally, it is the guidance of national policies and regulations. The European Union has formulated strict carbon emission laws, and China and the United States have also issued a series of regulations. These regulations support the development of ESG theory.

Environmental, social and corporate governance, as a concept of sustainable development, has a significant impact on social development. Good ESG performance can reduce enterprise risk, improve enterprise performance, enhance investor confidence, and increase the market value of the company [1]. This article mainly explains the impact of ESG on company valuation from four aspects: investor expectation, risk control, long-term strategy and asset utilization efficiency. ESG is an important factor for investors when making responsible considerations, and as a key member of society, companies should actively implement the concept of green development. From the perspective of risk control, ESG not only pays attention to short-term benefits and risks such as the current profitability of enterprises, but also pays more attention to the results of environmental performance, social performance and governance performance of enterprises based on the characteristics of ESG risk management and control, and measures their sustainable development ability in terms of environmental performance, social performance and governance performance. Enterprise long-term strategy refers to the importance of sustainable competitive advantages, the formulation of long-term strategies, the pursuit of long-term interests, that the future sustainable development is more important than the current, is an idea that can affect the development of enterprise strategy and decision-making [2]. But nowadays, some enterprises in China take profit maximization as the goal, often ignore the importance of long-term sustainable development strategy, resulting in behaviors that harm the environment, harm the interests of consumers, and are not conducive to the long-term development of enterprises. Finally, there is the issue of asset utilization efficiency, on which there is a great deal of disagreement. Some people believe that developing according to the ESG concept will reduce the efficiency of enterprise assets, while others do the opposite, which will be discussed below. The first three are positively correlated with company valuation, and the last asset utilization efficiency is negatively correlated with the impact of ESG.

2. Investor Expectation

The disclosure of ESG information can help investors better understand the company's general situation, so that they have a tendency to invest, better assess risks, and thus reduce investment risks.

As a rational individual, investors prefer companies to do something about the environment. In the context of the dual carbon goal, energy conservation and emission reduction, upgrading industrial structure is urgent, in the context of global warming, coping with climate change, reducing pollution is also a major matter.

Investors will think that companies with good ESG performance are more competitive, and companies that pay attention to environmental protection may benefit from the dividends brought by the government under the development of sustainable concepts [3]. For example, companies with good ESG performance usually receive government subsidies or tax benefits, which relieves their pressure on innovation funds, saves innovation costs, and helps companies to innovate better. Actively expand green development business. In terms of society, good ESG performance is also conducive to the development of talents of the company. People will see that the company undertakes social responsibility, and it will attract more responsible employees and talents to enter the company, and improve the income generation of the company. In terms of corporate management, if a company's internal structure is more stable, the relationship between superiors and subordinates is friendly, and the division of responsibilities is clear, it also means that the company's resource utilization rate and work efficiency are higher, investors will also think that such a company can bring better returns, and then more willing to invest.

Now the hot new field, renewable energy companies such as BYD. In the latest Fortune Global 500 list, BYD was honored to be listed, occupying the 212th place, compared with the ranking in 2023, achieving an amazing jump of 224 places, and becoming the fastest rising Chinese enterprise representative this year. Looking back at 2023, BYD achieved a 96.2% year-on-year growth with an annual operating income of 424.061 billion yuan, and all core business indicators refreshed the historical peak. It is particularly worth mentioning that BYD has made breakthrough progress in the field of new energy vehicles, with annual global sales of up to 1.86 million, successfully topping the global sales of new energy vehicles.

At present, the new energy automobile industry is ushering in its golden age of vigorous development, and this trend has been fully supported by the national level and widely recognized by the public. The "New energy Automobile Industry Development Blueprint (2021-2035)" recently issued by the General Office of the State clearly points out that it will focus on integrated innovation, overcome core key technologies, and optimize the industrial ecology, aiming to promote China's new energy automobile industry to a high-quality and sustainable development path, and accelerate the vision of building an automobile power [4]. In addition, as a strategic emerging industry supported by the State, the new energy automobile industry has also enjoyed a series of preferential policies and subsidy measures issued by the state, which has injected strong impetus for its sustainable and healthy development. The company promotes the development of new energy vehicles, reduces vehicle exhaust emissions, and makes positive contributions to global climate change and industrial transformation [5]. It also promotes the improvement of energy efficiency, actively advocates green travel for the public, and conforms to the concept of sustainable development. In line with today's environmental protection trend, investors expect BYD enterprise can obtain more market share and opportunities in the future investment transformation, so they are more willing to invest in the enterprise [6].

In terms of social factors let's take Starbucks as an example. At Starbucks, each employee has their own name tag, named after the favorite Starbucks coffee, giving employees a unique sense of belonging. This sense of belonging does not come in the form of chanting slogans or brainwashing; it comes from a deep sense of identification and reassurance with the company. It has also proposed a plan where it employs more than 90 people who work at least 20 hours a week, and even part-timers can participate in stock options as planned, receiving 15% of their salary to become a Starbucks "partner" [7].

This program not only encourages employees to work for the enterprise through soft management, but also promotes the rise of the stock price to a certain extent. As a service industry, Starbucks knows the importance of employee service to the enterprise, so it conducts more systematic training for employees, so that employees can better understand the enterprise and provide services for customers [8]. Compared with other mechanisms, in addition to providing training and reward mechanisms for employees, the more transparent promotion mechanism of the company makes the workplace of Starbucks more transparent, and the more transparent and fairer environment of Starbucks coffee than other coffee shops is one of the reasons why it can retain employees. Ordinary employees are green aprons and black aprons, and the black apron is the "coffee master", which has its own name sewn on it, and is a symbol of status. A coffee-colored apron stands for "coffee minister," and the highest rank in Starbucks is rare. Its rank rises through regular surveys and gains through employee expertise, coffee production and product innovation. As long as people are willing to learn, willing to work hard, even ordinary employees have the opportunity to wear their own name of the black apron.

It has made a series of moves to gain customer loyalty, and the stability of passenger flow has led to a steady increase in sales. Starbucks has invested a lot in the development and training of employee welfare benefits, which is conducive to cultivating high-quality employees, thus enhancing its corporate image and performing well in social aspects, which can significantly reduce its financing cost and gain more favor from investors.

Finally, in terms of corporate governance, Toyota Motor Company has advanced management mode, high production efficiency and perfect internal supervision system, which can reduce production costs and establish long-term stable relationships with suppliers.

3. Risk Management

In today's era, ESG is adopted as the first concept by various companies, but there are not many enterprises that really practice the concept of ESG green environmental protection. Most enterprises take the opportunity of ESG disclosure to create an image of adhering to green and sustainable development for enterprises, but they actually fail to do so. In ESG report or sustainability report, Exaggerated promises and disclosures about environmental protection and resource use.

As a beverage giant, Coca-Cola has repeatedly appeared "greenwashing" behavior. "Greenwashing" is a behavior in which enterprises or financial institutions exaggerate their efforts and achievements in the field of environmental protection. In terms of environment, the influential "chlorinated gate" of Coca-Cola Company analyzed the economic consequences of greenwashing behavior on enterprises, and combined with the current institutional environment, proposed countermeasures to control greenwashing behavior, so as to promote enterprises to green development and sustainable development [9].

After the Coca-Cola Company tackled the greenwashing problem, it set an example for other enterprises in water resource management, formulated water resource management plans, carried out water resource protection projects in water-scarce areas and did a good job in risk control, which was conducive to gaining consumer trust and enhancing brand influence.

In the social aspect, NIKE's labor problems are particularly prominent before the poor environment of the foundry and low wages, "Nike" believes in the power of sports. The company's website states:

"Our mission is to bring inspiration and innovation to every athlete in the world. If you have a body, you are an athlete." This mission statement positions Nike as a hopeful and inclusive brand that offers cutting-edge clothing and footwear for any body. If Nike believes it has the most innovative sportswear in the world, then actively introducing its products and, more importantly, its philosophy globally aligns with the organization's mission to expand the impact of its brands, products and values on all people.

The Company's mission and its statement of purpose establish the terms of its engagement and lay the platform for social change based on equality, inclusion, and empowering individuals and communities to take action. In 2019, however, Nike was celebrated for its engagement with social justice issues and its decision to become an outspoken advocate for those issues. At the same time, when a company that benefits directly from the sale of sports apparel, athlete sponsorship, and the commodification of athletes' bodies starts speaking out on social justice issues, there's good reason to be skeptical. There is no doubt that sports is big business, especially in the United States, where multi-million dollar corporate sponsorships for star athletes abound [10]. In fact, Sports Illustrated (2018) ranked the top 10 athletes based solely on endorsement income, and the combined earnings of these top athletes were close to $400 million. Secondly, Nike is also the world's most valuable sports goods company, its brand value reached $32.4 billion in 2019, Nike ranked 90th in the 2019 Fortune 500 total revenue ranking, Walmart ranked first with more than $500 billion in revenue. Therefore, people can think that Nike has a wide range of influence, strong financial resources, strong corporate voice, and great influence. Given Nike's past indiscretions, how the company uses its resources to engage in social advocacy deserves academic attention.

At present, the company has strengthened audit, improved the working conditions of the foundry, increased the wages of workers, and conducted regular supervision. Now the market efficiency is getting better and better, which shows that risk control has a good impact on the improvement of enterprise valuation.

4. Long Term Strategy

As one of the world's largest telecom equipment suppliers, Huawei has a profound sense of social responsibility, and what it does is of great significance to the sustainable development of other companies. It also pursues a long-term sustainable development strategy. Long-term commitment to the promotion and research and development of green communication technology, green sustainable development strategy. Continuously improve the efficiency of new energy use and make great contributions to environmental sustainability. He pioneered the Tran-cube methodology, pursued zero carbon emissions and A healthier ecological environment, and was honored as the only Chinese enterprise to receive such an honor in the carbon information Disclosure project.

In terms of employee management and maintenance, Huawei has also set a good example. Huawei has various ways to motivate its employees. The most direct incentive is bonus. When employees achieve or exceed performance, the company will reward them with high bonuses. The second is the equity incentive mechanism, which also has a good effect of improving the enthusiasm of employees. It closely associates the income of employees with the performance of the company, and stimulates the enthusiasm of employees. Last but not least, cultural stimulation has a subtle influence on a person. It is essential to enhance employees' recognition of corporate culture and enhance their loyalty to the company [11]. Only when employees treat the company as their home can they create more value.
In addition, it has a very complete management system to ensure that everyone can perform their duties in their own positions,

It will be assessed regularly, for the later work to find out the shortcomings, and better development. Long-term to provide employees with a good platform and welfare benefits. In terms of governance, he insists on independent research and development of new products to ensure the scientific nature of the company's products and the transparency of research and development.

5. Cost Efficiency

In some industries, the higher the ESG performance, the lower the margin. For example, a renewable energy company. A solar photovoltaic company, in order to comply with strict environmental standards, uses more environmentally friendly but more expensive raw materials in the production of solar panels. For example, the use of new photovoltaic materials without harmful substances such as cadmium, the procurement cost of this material is 20% higher than that of traditional cadmium-containing materials. At the same time, in order to ensure good performance at the social level, when enterprises build solar power stations in poor areas, they invest a lot of money in local infrastructure construction and resident training, which is also very high. From the perspective of corporate governance, the company has established a very transparent and strict quality control and employee welfare system, and the cost of internal supervision has also increased. While these measures have enabled the company to perform well in terms of ESG ratings, in the short term, profits have been reduced compared to less ESG-focused peers due to a significant increase in costs.
Another example is a garment manufacturer

A clothing brand decided to use organic cotton as its main raw material to meet higher environmental requirements. The price of organic cotton is about 1.5 times that of regular cotton. On the social side, the company provides employees with wages and benefits above the industry average, including comfortable staff dormitories, training opportunities and so on. In terms of corporate governance, the company has actively established a transparent supply chain traceability system to ensure that all aspects of clothing production meet ethical and quality standards, which has also increased operating costs. These practices have made the brand perform well in ESG, but due to increased costs, relatively high product prices, market share has been affected to a certain extent, and profits have been reduced.

Finally, Peabody Coal Company, if they want to improve ESG performance, they must first invest a lot of money to upgrade equipment, pollution prevention management, such as upgrading equipment, research and development of new tools, etc., in the early stage of transformation, profit margins will decline. These cases all show that not all enterprises with good ESG performance will achieve higher profit margins, on the contrary, it may be precisely because of better ESG performance but lower profit margins, showing an inverse relationship.

6. Conclusion

The purpose of this paper is to study the impact of ESG performance on the valuation of a company, respectively from the four aspects of investor expectations, risk management and control and long-term strategy, asset utilization efficiency, etc., and draw conclusions by taking some specific boss companies as examples. In summary, it can be seen that except for the negative correlation between asset utilization efficiency and ESG, other aspects are positively correlated. It is urgent for enterprises to implement the concept of ESG. If enterprises want to achieve green and sustainable development, they must make great efforts in environmental, social and governance.

In this rapidly developing society, enterprises should deepen the concept of ESG to all levels of the company, and improve the identity of the company's employees. The ESG concept is gaining momentum, so it is inevitable that a number of problems will arise. This reminds that it needs to strengthen the construction of laws and regulations, and specially formulate laws to ensure the objectivity and accuracy of ESG disclosure by enterprises. Second, it needs to strengthen education, deeply inspire the ESG concept and train professional talents, so as to adapt to the rapid development of the industry. In general, ESG is no longer a choice, but a task that each country must complete, and in this context, higher requirements are put forward for all countries, societies, enterprises, including individuals.

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