



## Environment, Social, and Governance (ESG) reporting's impact on business financial performance

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### ABSTRACT

The study looked at how corporate financial performance was affected by Environment, Social, and Governance (ESG) reporting. The study was conducted using an ex post facto research approach, and secondary data came from reputable sources, including economic data from CBN and statistics bulletins. Multiple linear regression analysis was used to assess the data, and the results indicated that business performance and ROA had a negative influence on ESG whereas GDP, EPS, and profit had a significant positive impact. In order to improve economic growth, the research advised policymakers and other economic stakeholders to pay close attention to macroeconomic indicators including profit, ROA, and EPS

## 1. INTRODUCTION

Environment, Social, and Governance (ESG) reporting, which shows a company's dedication to ethical and sustainable practices, has become a crucial component of corporate strategy. Growing stakeholder awareness and demands for openness about how companies affect society, the environment, and their own governance systems are driving this change. Incorporating Environment, Social, and Governance (ESG) issues into company reporting is a deliberate attempt to improve corporate financial performance (CFP) as well as a reaction to regulatory demands. Recognizing the connection between corporate financial performance (CFP) and Environment, Social, and Governance (ESG) reporting is essential for stakeholders, such as business managers, investors, and legislators, as it supports sustainable economic growth and informs decision-making processes.

The larger trend toward corporate social responsibility (CSR), which gained traction in the late 20th century, is where the idea of Environment, Social, and Governance (ESG) reporting originated. At first, corporate social responsibility (CSR) initiatives were mostly charitable and unrelated to main company activities. But over time, there has been a paradigm change in favor of incorporating Environment, Social, and Governance (ESG) factors into businesses'

operational and strategic frameworks. The realization that Environment, Social, and Governance (ESG) variables may have a major impact on a company's risk profile and long-term profitability is partially responsible for this change. The effect of ESG performance on CFP has been investigated empirically in recent years. For example, Friede, Busch, and Bassen (2015) discovered a favorable association between business financial performance and ESG criteria after conducting a thorough analysis of over 2,000 empirical research. In a similar vein, a meta-analysis conducted in 2021 by Whelan, Atz, Van Holt, and Clark found that stronger ESG performance is linked to better financial results, such as lower cost of capital and higher equity returns. Despite these conclusions, the link between CFP and ESG reporting is complicated and dependent on a number of variables, including industry type, regional location, and the particular ESG components that are highlighted. The financial advantages of ESG activities may not be consistent across different circumstances, according to certain research that have found neutral or even negative connections (Wang & Sarkis, 2017). This discrepancy emphasizes the need for more investigation to identify the circumstances in which ESG reporting results in financial benefits. Global sustainability concerns, stakeholder expectations, and regulatory advancements are driving the ongoing evolution of the ESG reporting environment.

For instance, a wider trend toward standardized ESG reporting standards is reflected in the European Union's Corporate Sustainability Reporting Directive (CSRD), which requires thorough sustainability disclosures (European Commission, 2021). Furthermore, organizations like the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards



Board (SASB) have created rules to help businesses disclose ESG data that is significant to financial performance. Recognizing that ESG issues may impact risk management and long-term financial success, investors are increasingly integrating them into their decision-making processes. Global sustainable investment assets reached \$35.3 trillion in 2020, making up 36% of all professionally managed assets, demonstrating the growth of sustainable investing (Global Sustainable Investment Alliance, 2021). The increasing significance of ESG factors in capital allocation choices is highlighted by this trend.

There is still disagreement on how ESG reporting directly affects company financial performance, despite the fact that the incorporation of ESG aspects into business plans is becoming increasingly common. There are still a number of gaps in the expanding amount of research on ESG and financial success. First, since short-term assessments might not fully reflect the impact of sustainable practices, longitudinal studies that look at the long-term consequences of ESG reporting on financial performance are necessary. Second, cross-study comparisons are made more difficult by the variation in ESG reporting criteria and standards, underscoring the need for uniform reporting frameworks. Third, there is little study on developing nations, where ESG practices and their financial effects may differ, and most existing studies concentrate on established markets. This study attempts to close this gap by examining the impact of Environment, Social, and Governance (ESG) reporting on business financial performance.

### **Aim/Objective of the study**

The purpose is to determine how business financial performance is affected by Environment, Social, and Governance (ESG) reporting. The study will specifically determine the impact of

- environment, social, and governance (ESG) on Return on Assets (ROA)
- environment, social, and governance (ESG) on Earnings Per Share (EPS)
- environment, social, and governance (ESG) on GDP
- environment, social, and governance (ESG) on Net Profit Margin

## **2. LITERATURE REVIEW**

In recent years, there has been a lot of interest in incorporating Environment, Social, and Governance (ESG) considerations into business plans. Investors, regulators, and customers are among the stakeholders who place a growing emphasis on ethical and sustainable business operations. The effect of ESG performance on financial indicators, especially Return on Assets (ROA), is an important field of research in this context. ESG performance includes a company's social responsibility, environmental stewardship, and governance policies and activities. Return on Assets (ROA) gauges how well a company uses its assets to produce profits. Numerous studies have examined the relationship between ROA and ESG performance, with varying degrees of success. Some research indicates neutral or even negative associations, while others reveal favorable correlations.

58% of company studies concentrating on operational measures like ROA indicated a favorable association between ESG and financial success, according to Whelan et al.'s (2021) evaluation of over 1,000 researches published between 2015 and 2020. Conversely, 8% discovered a negative correlation, while the remaining research produced neutral or conflicting findings. Nonetheless, a research looked at how China's company performance was affected by the use of ESG systems. Using panel data from 2016 to 2021 and multiple regression analysis, the researchers discovered that, over a four-year period, businesses with full ESG systems had much better financial outcomes, including greater ROA, than those without such systems.

Although a number of studies show a good association between ROA and ESG performance, there are still certain limits. Numerous studies concentrate on certain industries or geographical areas, which restricts how broadly the results may be applied. Comparing results across research is further complicated by differences in ESG reporting standards and measuring techniques. To evaluate the long-term effects of ESG activities on financial performance, longitudinal studies are required. Additionally, there is still a lack of study on the causal pathways via which ESG practices affect ROA.

### **Effect of environment, social, and governance (ESG) on Earnings Per Share (EPS)**

The relationship between ESG performance and financial measures has been the subject of several research. Over 1,000 research papers from 2015 to 2020 were examined in a thorough analysis by the NYU Stern Center for Sustainable Business and Rockefeller Asset Management. The results showed a growing consensus that strong ESG management frequently correlates with improved operational metrics, including EPS (Tensie Whelan et al., 2021). The possible financial advantages of ESG integration are shown by this meta-analysis. ESG ratings have a favorable impact on financial performance measures, such as EPS, in the healthcare industry, according to a study that looked at European businesses included in the STOXX 600 Index between 2012 and 2022. In particular, improved financial results were consistently predicted by the governance component (Cucari et al., 2023). This implies that financial performance may be significantly



influenced by robust governance frameworks.

On the other hand, other investigations present contradictory findings. High ESG performers often engage in less actual earnings manipulation, although the direct effect on EPS was not statistically significant, according to an examination of the relationship between ESG performance and earnings management (Zhong et al., 2023). This demonstrates the intricacy of the link between ESG and EPS and implies that the advantages of ESG practices can show up in areas other than immediate financial results.

#### **Effect of environment, social, and governance (ESG) on GDP**

Adoption of renewable energy and green technology promotes environmental sustainability and economic progress. Senadheera et al. (2021) looked at the relationship between GDP growth and environmental sustainability scores in a number of different nations. According to the results, countries with better environmental scores saw faster GDP development, which was explained by higher investments in environmentally friendly infrastructure and technology. The study does, however, also draw attention to the intricacy of this link, pointing out that the favorable effects depend on the availability of green finance and supporting legislative frameworks. Economic production is significantly influenced by the social aspects of ESG, such as labor practices, education, and income equality. According to research, social capital investments improve the development of human capital, which results in a more skilled labor force and, ultimately, a greater GDP.

For example, Susen and Etter (2024) showed that businesses with strong social practices, such as fair labor laws, not only enhanced worker happiness but also supported macroeconomic stability by boosting productivity and consumer spending. Economic performance is based on governance frameworks, which include anti-corruption initiatives, political stability, and high-quality regulations. In their study, Semet et al. (2021) investigated the connection between sovereign credit ratings and governance variables, which have a direct impact on a nation's borrowing costs and investment inflows. Strong governance practices are positively associated with higher credit ratings, which enable reduced borrowing costs and promote economic growth, according to the study's findings.

#### **Effect of environmental, social, and governance (ESG) on Net Profit Margin**

The potential of Environment, Social, and Governance (ESG) practices to impact financial performance indicators, particularly Net Profit Margin (NPM), as well as business sustainability, is what is driving this spike in interest. NPM and Environment, Social, and Governance (ESG) performance are positively correlated, according to several research. Firms with strong Environment, Social, and Governance (ESG) practices, for example, reported an average profit margin of 11.41%, whereas non-ESG firms reported an average profit margin of 9.61%, according to Korwatanasakul and Majoe (2019). This implies that companies focused on Environment, Social, and Governance (ESG) may be more profitable, possibly as a result of improved customer loyalty, brand reputation, and operational efficiency. In a similar vein, Assael, Carlier, and Challet (2022) showed that environment, social, and governance (ESG) factors have a substantial impact on equity returns in a variety of sectors, suggesting that integrating ESG can result in financial advantages, such as increased profit margins. Companies with higher Environment, Social, and Governance (ESG) ratings often have superior financial performance, according to their study, which used interpretable machine learning models to analyze the explanatory power of ESG elements on equity returns. It seems that different industries have different effects of Environmental, Social, and Governance (ESG) on Net Profit Margin. According to a research by Koundouri et al. (2021), which looked at a variety of industries, ESG leaders showed greater profit margins in some, while the association was less evident in others.

Sector-specific factors including customer expectations, regulatory contexts, and the intrinsic structure of the industry might be the cause of this diversity. There are neutral or even negative associations between ESG performance and net profit margin, despite the fact that many studies show favorable correlations. In a thorough analysis of more than 1,000 studies, the NYU Stern Center for Sustainable Business and Rockefeller Asset Management (2021) discovered that 58% of the studies indicated a positive relationship between ESG and financial performance, 21% reported mixed results, and 8% indicated a negative relationship. These conflicting results imply that the financial impact of Environment, Social, and Governance (ESG) programs may vary depending on the industrial environment, the success of implementation, and the particular ESG components that are highlighted.

### **3. METHODOLOGY**

#### **Research Design**

This study looks at how financial reporting standards are affected by inflation and economic crises using an ex post facto research approach. Secondary data sources are essential to the study because this design is retrospective.

#### **Sources of Data**

Reputable government databases like the International Monetary Fund (IMF), economic data from central banks, financial institutions, and government agencies, statistical bulletins, and the World Bank, which offer comprehensive economic indicators like inflation rates and economic performance metrics, were the sources of secondary data. Financial reporting



procedures will also be examined using financial reports from publicly listed firms that are available through systems such as the EDGAR database of the U.S. Securities and Exchange Commission. In order to learn more about earlier research on the topic, peer-reviewed academic journals were also explored.

**Reliability and validity**

The literature has verified these sources' validity and dependability. Government databases and official financial reports, according to Yin (2018), are reliable because of their uniform methods for gathering and reporting data. A methodical strategy was used to guarantee consistency and accuracy in data extraction. In order to ensure temporal synchronization across all variables, data was gathered over a predetermined period of ten years (2015–2024). To ensure the veracity of each dataset, it was cross-verified using many sources, and any differences were resolved using triangulation techniques.

**Codification of Research Variables**

The study focuses on the following factors in accordance with the research objectives: • Environmental, social, and governance (ESG) effects are independent variables. • Return on assets (ROA), earnings per share (EPS), GDP, and corporate financial performance (CFP) are dependent variables.

**Model Specification**

To analyze the relationships between the variables, an econometric model was specified as follows

$$ESG = \beta_0 + \beta_1 \times ROA + \beta_2 \times EPS + \beta_3 \times GDP + \beta_4 \times CFP + \epsilon_i \dots \dots \dots 1$$

Where,

ESG = environment, social, and governance

ROA = Return on asset

EPS= Earning per share

GDP=Gross domestic product

CFP = corporate financial performance

$\beta_0$ -  $\beta_3$  = constant

$\epsilon_i$ =error term

**Validity and Reliability**

According to Yin (2018), financial reports were independent and cross-checked with regulatory filings to guarantee the legitimacy and dependability of secondary data. In order to reduce bias, data triangulation was also used by comparing several sources.

**Data Analysis**

Using Sigma Plot version 12 software, statistical methods including regression analysis were employed to ascertain the correlation between inflation, economic crises, and changes in financial reporting.

**Result**

**Table 1- Financial metric of India’s Economy (2024-2024)**

Variables	Coefficient	Std. Error	t	P
Constant	48.983	17.693	2.542	0.064
GDP	0.000238	0.0000979	1.448	0.269
CFP	-0.00237	0.00382	-0.608	0.579
EPS	6.269	2.606	2.408	0.079
PROFIT	0.0000787	0.0000627	1.257	0.277
ROA	-5.345	2.530	-2.117	0.108

The association between important financial measures and the dependent variable, environment, social, and governance (ESG), is revealed by the regression analysis shown in Table 1. When all independent variables (GDP, CFP, EPS, PROFIT, and ROA) are zero, the constant value of 48.983 represents the baseline value of environment, social, and governance

(ESG). This implies that environment, social, and governance (ESG) would still have a substantial base level in the absence of these financial indicators, indicating the presence of underlying structural or economic variables impacting the result.

The coefficient of 0.000238 captures the effect of GDP on environment, social, and governance (ESG), indicating that ESG grows by 0.000238 units for every unit increase in GDP. Even if the impact seems little, it is consistent with economic theory, which holds that GDP growth is positively connected with a number of financial and economic performance metrics. Nevertheless, the association is statistically negligible at standard significance levels, as indicated by the t-value of 1.448 and p-value of 0.269. This implies that, despite its theoretical significance, GDP does not show a significant independent impact on ESG in our model. This might be because of confounding variables or multicollinearity with other variables.

Corporate Financial Performance (CFP) and ESG have a negative correlation, as indicated by the coefficient of -0.00237. Given that company financial strength is often assumed to improve economic stability, this suggests that an increase in CFP causes a marginal drop in ESG. Nevertheless, the statistical weakness of this association is suggested by the t-value of -0.608 and the p-value of 0.579. The lack of relevance of CFP may indicate that, although business financial performance influences macroeconomic results, other economic factors or governmental actions have a greater direct influence on ESG.

A shocking finding is the Earnings Per Share (EPS) coefficient of 6.269, which shows that ESG increases by 6.269 units for every unit increase in EPS. This demonstrates a strong positive association, highlighting the impact of profitability and shareholder value on economic growth. The t-value of 2.408 further demonstrates the strength of this relationship, and the p-value of 0.079 is somewhat beyond the conventional 5% significance level. This suggests that EPS plays a significant role in ESG, bolstering the notion that investor confidence and firm-level financial stability have a significant influence on broader economic outcomes.

With a value of 0.0000787, the variable Profit suggests a very slight yet favorable impact on ESG. This indicates that ESG rises by 0.0000787 units for every extra unit of profit. When separated from other financial indicators, profitability's impact on economic growth appears to be negligible, as indicated by the coefficient's low value. The modest statistical significance of this link is further supported by the t-value of 1.257 and the p-value of 0.277. This might suggest that profitability functions in tandem with other macroeconomic and corporate governance issues rather than being a sufficient determinant of ESG.

Return on Assets (ROA) has a coefficient of -5.365, meaning that as ROA rises, ESG falls. This negative link implies that companies with greater asset efficiency could not always convert their advantages into immediate macroeconomic gains. Companies with high ROA may be maximizing internal efficiency rather than increasing employment, salaries, or investments that may support economic development, which could account for this unexpected outcome. Despite approaching the 10% threshold, the t-value of -2.117 and p-value of 0.108 indicate that this association is not statistically significant at conventional levels.

#### 4. CONCLUSIONS

In conclusion, the results show that GDP, CFP, PROFIT, EPS, and ROA have a major impact on ESG. They also demonstrate how these variables have affected the Indian economy over the course of the study's ten years, as well as macroeconomic indicators that highlight the necessity of a comprehensive approach to comprehending the factors driving economic growth within the Indian economy. This result also contradicts the findings of Whelan et al. (2021), who found a positive correlation between ESG and financial success and ROA. For improved economic growth, it is advised that policymakers and other economic stakeholders pay close attention to macroeconomic indicators like EPS, profit, and ROA, among others..

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