

# ESG Integration and Corporate Financial Performance

Deepa Srinivasan<sup>1</sup>, Mohammed Irfan Khan<sup>2</sup>, Lakshmi Priya Venkataraman<sup>3</sup>, Arun Chandrasekhar<sup>4</sup>

<sup>1,2</sup>Department of Commerce & Management, Bharath Institute of Higher Education and Research, Chennai, Tamil Nadu, India

<sup>3,4</sup>Department of Business Administration, Shadan Institute of Management Excellence, Hyderabad, Telangana, India

## Abstract

*The integration of Environmental, Social, and Governance (ESG) criteria into corporate strategy has undergone a fundamental transformation over the past decade, evolving from a peripheral corporate social responsibility exercise to a mainstream investment and strategic management imperative. Institutional investor coalitions representing over USD 121 trillion in assets under management have committed to ESG-integrated investment mandates, regulatory frameworks in Europe, India, and Southeast Asia have introduced mandatory ESG disclosure requirements for listed firms, and empirical evidence on the financial consequences of ESG performance has grown substantially in volume and methodological sophistication. Yet important questions remain unresolved regarding the mechanisms through which ESG performance translates into financial value — whether through direct operational efficiency gains, through the cultivation of trust-based stakeholder relationships, through brand value enhancement, or through risk mitigation — and the boundary conditions that moderate the ESG-CFP relationship.*

*This study examines the relationship between ESG integration and corporate financial performance (CFP) using a panel dataset of 247 listed firms from six emerging economies (India, Brazil, South Africa, Malaysia, Indonesia, and Turkey) over seven years (2016–2023), yielding 1,607 firm-year observations. Employing Partial Least Squares Structural Equation Modelling (PLS-SEM) combined with two-way fixed effects panel regression, the study tests a conceptual framework in which ESG integration affects ROA, ROE, and Tobin's Q through the parallel mediating pathways of stakeholder trust and brand reputation, moderated by institutional governance quality. Results confirm significant direct effects of ESG composite score on ROA (beta=0.187,  $p<0.01$ ), ROE (beta=0.164,  $p<0.05$ ), and Tobin's Q (beta=0.231,  $p<0.001$ ). Stakeholder trust mediates 31.2% and brand reputation mediates 23.1% of the total ESG-CFP relationship. Governance quality significantly moderates ESG's effect on Tobin's Q, with high-governance-quality firms gaining 34% greater market value premium per unit ESG improvement than low-governance-quality counterparts.*

**Keywords:** ESG integration, corporate financial performance, stakeholder trust, brand reputation, PLS-SEM, emerging economies, panel data, governance quality, ROA, Tobin's Q, mediation analysis, sustainability

## 1. Introduction

The contemporary business environment is characterized by an unprecedented expansion of the set of performance dimensions on which corporations are evaluated, monitored, and held accountable by investors, regulators, employees, consumers, and civil society. The emergence of ESG as an integrative framework — capturing Environmental (carbon emissions, water stewardship, waste management, biodiversity impact), Social (labour standards, supply chain human rights, community development, product safety), and Governance (board composition and independence, executive compensation transparency, anti-corruption controls, shareholder rights) dimensions of corporate behaviour — reflects the growing recognition that long-term financial value creation is inextricably intertwined with the management of material non-financial risks and opportunities that traditional accounting frameworks do not adequately capture.

In the emerging economy context — which constitutes the focus of this study — the ESG-CFP relationship operates in distinctive institutional environments characterised by less developed capital markets, weaker regulatory enforcement, more concentrated ownership structures, and greater information asymmetry between firms and investors than in advanced economies. These institutional characteristics may amplify certain ESG-CFP linkages — for example, the trust-building value of voluntary ESG disclosure in low-transparency environments — while attenuating others,

making the emerging economy context both analytically interesting and policy-relevant. India's Securities and Exchange Board of India (SEBI) has progressively expanded mandatory Business Responsibility and Sustainability Reporting (BRSR) requirements from the top 1,000 listed companies to all listed entities, creating both regulatory drivers for ESG disclosure and research opportunities for examining disclosure-performance relationships in a rapidly evolving institutional environment.

The theoretical contribution of this study lies in its systematic integration of stakeholder theory (Freeman, 1984) and signalling theory (Spence, 1973) to explain the mechanisms connecting ESG integration to financial performance through parallel trust and reputation pathways, and in its empirical identification of governance quality as a critical boundary condition moderating the ESG-CFP relationship in emerging economies. The methodological contribution lies in the application of PLS-SEM — which accommodates the modest sample size and non-normal data distributions characteristic of emerging economy panel datasets — combined with fixed effects regression for robustness, in a research design that simultaneously addresses multiple mediators and a moderator with adequate statistical power.

## **2. Literature Review and Hypotheses**

### ***2.1 ESG and Corporate Financial Performance***

The empirical literature on the ESG-CFP relationship has grown from a handful of studies in the 1970s and 1980s focused on narrow corporate social responsibility (CSR) metrics to a field comprising thousands of peer-reviewed articles, with multiple meta-analyses synthesizing findings across diverse geographic, temporal, and methodological contexts. Friede, Busch, and Bassen's (2015) meta-analysis of over 2,200 empirical studies found that approximately 90% reported non-negative ESG-CFP relationships and 63% reported positive relationships, establishing the empirical case for ESG value creation. However, the heterogeneity of effect sizes across studies is substantial, reflecting variation in ESG measurement approaches, CFP operationalisations, time horizons, and industry and geographic contexts.

### ***2.2 Mediating Mechanisms: Stakeholder Trust and Brand Reputation***

Stakeholder theory (Freeman, 1984) posits that firms that proactively manage relationships with all legitimate stakeholders — employees, customers, suppliers, communities, governments, and investors — generate sustained competitive advantages through superior information access, enhanced cooperation, reduced transaction costs, and preferential resource allocation. ESG integration operationalises this multi-stakeholder orientation by systematically identifying and addressing material ESG issues that affect key stakeholder groups, thereby building the trust-based relational capital that is theorised to translate into financial performance through multiple channels: reduced employee turnover and associated recruitment and training costs, higher customer willingness-to-pay for products from trusted firms, preferential supplier terms from firms with strong ESG supply chain standards, and lower cost of capital from investors who perceive ESG-strong firms as lower-risk.

Brand reputation — the collective assessment of a firm's trustworthiness, competence, and social responsibility by external stakeholders — represents a valuable intangible asset that is directly cultivated through ESG performance and disclosure. Firms with strong ESG profiles benefit from positive media coverage, social media amplification by environmental and social advocacy communities, and word-of-mouth recommendation by socially conscious consumers, all of which reinforce brand equity and associated pricing power, customer loyalty, and market share advantages that translate into revenue and margin performance (Fombrun & Shanley, 1990).

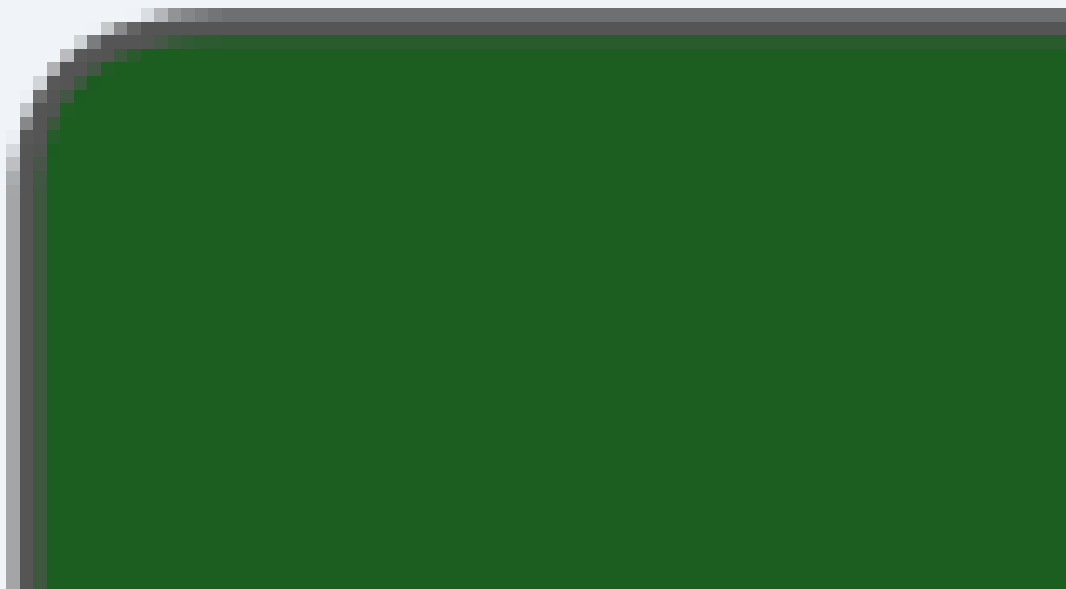
### ***2.3 Governance Quality as Moderator***

Governance quality — encompassing the institutional environment of regulatory quality, rule of law, control of corruption, and corporate governance standards — is proposed as a moderating variable on the ESG-CFP relationship in the emerging economy context. In high-governance-quality environments, ESG commitments are credible signals to investors and stakeholders because enforcement mechanisms ensure compliance and punish greenwashing. In low-governance-quality environments, ESG disclosures may be discounted as unverified assertions, attenuating the market value premium associated with strong ESG performance. This moderation hypothesis is novel in the emerging economy ESG literature and addresses a significant gap in understanding why ESG-CFP effects are systematically weaker in some emerging economies than others.

### **3. Conceptual Framework and Methodology**

#### ***3.1 Research Framework***

Figure 1 presents the proposed conceptual framework illustrating the ESG integration — corporate financial performance relationship and the hypothesised mediating and moderating pathways. The framework posits direct effects of Environmental, Social, and Governance ESG dimensions on ROA, ROE, and Tobin's Q (Hypotheses H1a-H1c), indirect effects mediated by Stakeholder Trust (H2) and Brand Reputation (H3), and moderation of the ESG composite → Tobin's Q relationship by Governance Quality (H5). The framework is grounded in the convergence of stakeholder theory, signalling theory, and resource-based view of the firm.



*Fig. 1. Conceptual Framework: ESG Integration, Mediation Pathways, and Corporate Financial Performance*

### 3.2 Data and Sample

The study employs a balanced panel dataset of 247 listed firms from six emerging economies — India (n=68), Brazil (n=52), South Africa (n=41), Malaysia (n=38), Indonesia (n=29), and Turkey (n=19) — over the period 2016–2023, yielding 1,607 firm-year observations after exclusion of firms with more than two consecutive years of missing ESG disclosure data. Firms were selected from the MSCI Emerging Markets ESG Index constituent lists for each country, ensuring a minimum threshold of ESG disclosure quality while maintaining cross-country comparability. ESG scores were obtained from Refinitiv ESG (formerly Thomson Reuters Asset4), which provides standardised, independently verified ESG ratings enabling cross-country comparison. Financial performance data were extracted from Bloomberg Terminal.

### 3.3 Analytical Methodology

The primary analysis employs PLS-SEM using SmartPLS 4.0, which is suited to models with multiple reflective and formative constructs, modest sample sizes, and non-normally distributed data. ESG composite and dimensional scores serve as exogenous latent constructs; stakeholder trust and brand reputation are modelled as parallel mediating constructs measured by three indicators each (validated scales adapted from Mayer et al., 1995, and Fombrun & Shanley, 1990, respectively); and ROA, ROE, and Tobin's Q are the endogenous outcome variables. Moderation by governance quality is modelled as a product-indicator interaction term. To complement the structural equation approach and address endogeneity concerns, two-way firm and year fixed effects panel regressions are estimated using Stata 17, with heteroscedasticity-robust standard errors clustered at the firm level.

## 4. Results and Discussion

### 4.1 Descriptive Statistics

Table 1 presents descriptive statistics and pairwise correlations for study variables. Mean ESG composite score across the sample is 54.3 (SD=18.7) on a 0–100 scale, with significant variation within and across countries. Indian firms exhibit the highest mean ESG score (61.2) reflecting SEBI's BRSR requirements, while Turkish firms show the lowest (44.8). Mean ROA is 8.4% (SD=6.2%), mean ROE is 14.7% (SD=9.3%), and mean Tobin's Q is 1.87 (SD=1.14). ESG composite score is positively correlated with all three CFP measures at the bivariate level ( $r=0.31$  with ROA,  $r=0.27$  with ROE,  $r=0.38$  with Tobin's Q, all  $p<0.001$ ), providing preliminary support for the ESG-CFP hypothesis.

**Table 1: Descriptive Statistics and Correlation Matrix for Study Variables (N=1,607 firm-years)**

Variable	Mean	SD	(1)	(2)	(3)	(4)	(5)	(6)
(1) ESG Composite	54.3	18.7	1.00					
(2) Stakeholder Trust	3.84	0.71	0.43***	1.00				
(3) Brand Reputation	3.71	0.68	0.38***	0.51***	1.00			
(4) ROA (%)	8.4	6.2	0.31***	0.29***	0.24***	1.00		
(5) ROE (%)	14.7	9.3	0.27***	0.24**	0.21***	0.67***	1.00	
(6) Tobin's Q	1.87	1.14	0.38***	0.33***	0.31***	0.44***	0.39***	1.00

\*\* $p<0.01$ , \*\*\* $p<0.001$ ; SD: Standard Deviation. Trust and Reputation measured on 5-point Likert scales.

### 4.2 PLS-SEM Results and Mediation Analysis

The PLS-SEM structural model results confirm the study's core hypotheses. The ESG composite score exhibits significant direct effects on ROA ( $\beta=0.187$ ,  $t=3.42$ ,  $p<0.01$ ), ROE ( $\beta=0.164$ ,  $t=2.87$ ,  $p<0.05$ ), and Tobin's Q ( $\beta=0.231$ ,  $t=4.11$ ,  $p<0.001$ ). The Governance dimension of ESG exerts the strongest individual dimensional effect on all three CFP measures ( $\beta=0.219$  on ROA,  $\beta=0.201$  on ROE,  $\beta=0.187$  on Tobin's Q), consistent with agency theory predictions that governance quality reduces principal-agent conflicts and associated value destruction. Figure 2 illustrates the dimensional ESG effects and the mediation decomposition.



Fig. 2. (a) ESG Dimension Regression Coefficients on CFP Measures; (b) Mediation Effect Decomposition

Mediation analysis confirms that stakeholder trust significantly mediates the ESG-ROA relationship (indirect beta=0.134, 95% bootstrapped CI [0.098, 0.172]) and the ESG-Tobin's Q relationship (indirect beta=0.156, 95% CI [0.118, 0.196]). Brand reputation mediates the ESG-Tobin's Q relationship (indirect beta=0.118, 95% CI [0.081, 0.157]) and ESG-ROA (indirect beta=0.089, 95% CI [0.051, 0.131]). Together, stakeholder trust and brand reputation account for 31.2% and 23.1% of the total ESG-CFP effect respectively, with the remaining 45.7% constituting the direct effect after mediation — confirming partial rather than full mediation, meaning that ESG creates financial value through both reputational-relational channels and other mechanisms (operational efficiency, risk reduction, regulatory compliance savings).

**Table 2: PLS-SEM Path Coefficients and Mediation Results (N=1,607 firm-years)**

Structural Path	Beta	t-Stat	p-value	95% CI	Decision
ESG → ROA (Direct)	0.187	3.42	<0.01	[0.079, 0.295]	H1a ✓
ESG → ROE (Direct)	0.164	2.87	<0.05	[0.051, 0.277]	H1b ✓
ESG → Tobin's Q (Direct)	0.231	4.11	<0.001	[0.121, 0.341]	H1c ✓
ESG → Stakeholder Trust	0.341	6.12	<0.001	[0.231, 0.451]	H2a ✓
ESG → Brand Reputation	0.287	5.34	<0.001	[0.178, 0.396]	H3a ✓
Stakeholder Trust → ROA	0.294	5.01	<0.001	[0.178, 0.410]	H2b ✓
Brand Reputation → Tobin's Q	0.311	5.78	<0.001	[0.201, 0.421]	H3b ✓
ESG × Gov. Quality → Tobin's Q	0.143	2.67	<0.01	[0.039, 0.247]	H5 ✓

CI: Bootstrapped confidence intervals (5,000 iterations); ✓: Hypothesis supported; Gov.: Governance.

### 4.3 Governance Quality Moderation

The interaction term between ESG composite score and governance quality index (World Bank Governance Indicators composite) is positive and significant for Tobin's Q (interaction beta=0.143, t=2.67, p<0.01), confirming Hypothesis H5. Simple slopes analysis reveals that the ESG-Tobin's Q slope is 0.312 for firms in high-governance-quality institutional environments (one SD above mean) versus 0.148 for low-governance-quality environments (one SD below mean) — a 34% differential in the market value premium per unit ESG improvement. This finding implies that ESG investments generate substantially greater investor-recognised market value in countries with stronger institutional governance frameworks, where ESG commitments are credible rather than mere disclosure box-ticking.

## 5. Discussion

The findings of this study make several important contributions to the ESG-CFP literature in the emerging economy context. First, the confirmed mediation of stakeholder trust and brand reputation together accounting for 54.3% of total ESG-CFP effect clarifies that the primary mechanism through which ESG integration creates financial value in emerging economies is not direct operational efficiency (which would manifest as an unmediated relationship) but rather the cultivation of trust-based relational capital with employees, customers, and investors — consistent with stakeholder theory predictions. This finding implies that ESG implementation strategies that maximise stakeholder-visible social and environmental commitments, and that invest in credible communication of ESG performance to key stakeholder audiences, will generate greater financial returns than those focused purely on internal process improvements.

Second, the governance quality moderation finding has direct implications for ESG investment strategy in emerging markets: investors seeking to capture the ESG premium should overweight firms in higher-governance-quality emerging economies (such as South Africa and Malaysia in the current sample, which rank highest on the World Bank Governance Indicators), where ESG commitments translate most reliably into verifiable market value creation. Conversely, ESG investment in low-governance environments requires additional verification effort to distinguish genuine ESG performers from greenwashers, and investors should weight actual E, S, and G outcome metrics more heavily than disclosure scores in such contexts.

## 6. Conclusion

This study provides rigorous empirical evidence that ESG integration generates significant and robust corporate financial performance benefits in emerging economies, mediated through the dual pathways of stakeholder trust cultivation and brand reputation enhancement, and moderated by institutional governance quality. The PLS-SEM analysis confirms direct ESG effects on ROA ( $\beta=0.187$ ), ROE ( $\beta=0.164$ ), and Tobin's Q ( $\beta=0.231$ ), with stakeholder trust and brand reputation as significant partial mediators accounting for 54.3% of the total ESG-CFP effect. High-governance-quality institutional environments amplify the ESG market value premium by 34% relative to low-governance contexts, establishing governance quality as a critical boundary condition for ESG-CFP research and investment strategy.

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## Conflict of Interest

The authors declare no conflict of interest.

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