International Journal of Scientific Research in Engineering and Management (IJSREM)
Volume: 08 Issue: 04 | April - 2024 SJIF Rating: 8.448 ISSN: 2582-3930

Impact of ESG Score on Stock Performance in Banking and IT Sector

Neelesh Kumar**, **Anugrah Srivastava

Under the Guidance of

Dr Surbhi Srivastava (Associate Professor)

Bachelor of Business Administration (Finance and Accountancy)

SCHOOL OF COMMERCE, FINANCE AND ACCOUNTANCY

CHRIST (DEEMED TO BE UNIVERSITY), DELHI NCR

Abstract

The awareness regarding Environmental, Social and Governance (ESG) has grown a lot in the recent past years. The paper mainly aims at investigating whether there is an existing relationship between the disclosure by the companies from the industry of Banking and Information Technology based upon Environmental, social and governance framework and the stock performance of the companies of the same industry. The study took variable as the ESG Score and annual share price of the top 5 companies each of Banking and Information Technology present in the NSE ESG INDEX between the FY2014 to FY 2023. The study has used correlation and ANNOVA to analyse the impact that ESG score has upon the share prices of the target companies. We have attained observation through our studies that the relationship that exists between the SDG score of 8 companies out of the 10 companies selected as a sample is significantly positive. This study mainly aims to determines the relationship amongst ESG disclosures and stock prices and if the relationship is positive, negative or neutral.

Keyword - ESG disclosure, ESG index, ESG Score, Stock Price, Firm performances

Introduction

In today's dynamic and interconnected world, the concept of Environmental, Social, and Governance (ESG) factors has transcended mere buzzwords and become a pivotal force shaping investment decisions and corporate behaviour. Gone are the days when financial returns ruled supreme; the awareness amongst the investors regarding the long-term impact of environmental degradation, social inequities, and poor governance practices on business sustainability and societal well-being. We can define ESG- Environmental: Pollution, resource depletion, climate change and responsible environmental management. Social: Labor practices, diversity, equity, inclusion, human rights, and community engagement. Governance: Corporate ethics, board structure, transparency, accountability, and anti-corruption measures.

The increasing demand for ESG-focused investment options is undeniable, driven by a confluence of ethical, risk management, and potential return-oriented factors. These are a few striking figures to paint a clear picture: Global Asset Growth: Assets under management (AUM) in ESG-focused investments: Surpassed $30 trillion globally in 2021. (Global Sustainable Investment Review 2022). Projected to reach $53 trillion by 2025, representing a 21.5% share of total global AUM. (PwC's Asset and Wealth Management Revolution 2022 report). Growing at a compound annual growth rate (CAGR) of 12.9%. (PwC report). Individual investors:83% of global individual investors are interested in sustainable investing. (Schroders Global Investor Study 2022). Millennials and Gen Z investors: These younger generations are particularly interested in ESG, with 75% considering sustainability elements that influences their financial choices. (US SIF Foundation Report on US Sustainable, Responsible and Impact Investing Trends 2022). Institutional investors:90% of institutional investors surveyed believe asset managers should be more proactive in developing new ESG products. (PwC report). Investors representing $41 trillion in AUM have signed onto the Principles for Responsible Investment (PRI), demonstrating their commitment to consider ESG aspects when making financial decisions. (PRI website). In the world according to (Morningstar Sustainable Research) Europe: Leading the way with €2.8 trillion invested in ESG funds in 2021. North America: Experiencing rapid growth, with ESG fund inflows of $649 billion in 2021. (Morningstar) Asia: Showing strong potential, with ESG AUM expected to reach $2.7 trillion by 2025. (Bloomberg Intelligence.

Until then, the most important topic that companies and investors need to address is whether or not ESG disclosure policies may result in improved firm performance (FP). Previous studies have attempted to investigate how ESG disclosure practices affect FP. A particular aspect of ESG, like environmental or social disclosure, most of these investigations (Smith et al., 2007; Ponnu, 2008; Barnett and Salomon, 2012a, 2012b; Han et al., 2016a, 2016b) focus on []. However, concentrating solely on one element may cause issues because ESG disclosure issues are interconnected. Slightly more ESG studies focus on all three dimensions of ESG and their effects on FP in a single setting (Gillan et al., 2011; Yeom, 2012; Balatbat et al., 2012; Galbreath, 2013; Pasquini-Descomps and Sahut, 2014a, 2014b; Sahut and Pasquini-Descomps, 2015; Sharma and Thukral, 2015; Tarmuji et al., 2016a, 2016b; Nollet et al., 2016b). What's more, these research' conclusions are unclear on whether ESG and its components have a neutral, positive, or negative effect on FP; rather, they present contradicting views. Thus, when evaluating the influence of ESG on FP, it is imperative to pay attention to all of its dimensions. Beyond ESG's obvious relationship to FP, more research is needed.

Impact of ESG disclosure on Stock Performance

Studies have been done to understand the relationship of the ESG disclosure and the stocks performance. While some existing papers have been indicative of the correlation between the ESG score and its impact while other studies have revealed that there is no relation between ESG performance and the stock return.

The impacts of environmental issues have been discussed in the literature from a number of perspectives. For example, Al-Tuwaijri et al. (2004) looked at the effects of environmental problems like recycling toxic discharges and hazardous wastes. Wagner and Schaltegger (2004) looked at the moderating role that corporate environmental strategy choice has on the link between environmental and economic performance in European industrial businesses. They concluded that, compared to organisations that do not implement shareholder value-oriented strategies, there is a larger positive association between environmental and economic performance for those who have.

Pedersen et al. propose that ESG scores provide information about firm fundamentals and affect investor preferences, outlining an ESG-efficient frontier that suggests portfolios can achieve the highest Sharpe ratio for each ESG level, which could result in better stock performance (Pedersen et al., 2021).

Research by Gary Pivo points to the financial benefits for property investors considering ESG issues. It is suggested that responsible property investing strategies, which include ESG considerations, can lead to greater returns on investments. This implies that ESG disclosure may have a good impact on stock prices since investors are starting to understand the importance of ESG when making decisions about their investment. (Pivo, 2008).

Impact Of ESG Disclosure on Financial Performance:

Research has highlighted the potential effect of ESG practices on various financial aspects of companies. Feng and Wu indicate that ESG disclosure can have implications for REIT debt financing (Feng & Wu, 2021), implying that improved ESG disclosure practices might affect a company's ability to secure financing and, consequently, its financial health.

The literature has covered the effects of environmental problems from a variety of angles. Al-Tuwaijri et al. (2004), for instance, examined the effects of environmental issues such hazardous wastes and recycling harmful releases. The link between environmental and economic success in corporations and the moderating influence of corporate environmental strategy decision in European industrial enterprises was examined by Wagner and Schaltegger (2004). They came to the conclusion that there is a stronger positive correlation between environmental and economic success for companies that have adopted shareholder value-oriented strategies than for those that do not.

The effect of ESG on financial statements can be intricate as it may influence both the cost of capital and operational costs. Firms with better ESG practices may enjoy lower cost of capital due to perceived lower risks and improved investor confidence. Conversely, the implementation of ESG practices can entail upfront costs that might impact short-term financial results but potentially contribute to long-term sustainability and financial stability.

In conclusion, while there is evidence to recommend that ESG disclosure can positively impact stock performance and financial statements, the research is diverse with some studies showing no significant relationship or even negative implications. Investors and companies may take advantage from more comprehensive ESG reporting as it could improve transparency and decision-making in the financial markets. However, further studies are essential to fully understand the nuances of these relationships and how they could be optimized for enhanced financial performance.

The effect of ESG disclosure on the banking and IT sectors can be significant, specified that these industries are increasingly scrutinized for their sustainability practices and their roles in broader economic systems.

IMPACT OF ESG DISCLOUSRE ON BANKING & IT SECTOR

Banking Sector

In the banking sector, ESG considerations are becoming pivotal in determining how banks conduct their business. ESG disclosures can have extreme implications for a bank's reputation, risk management, and customer base. Investors and regulators are particularly interested in how banks are directing their exposure to environmentally and socially risky assets.

Risk Management: Banks include ESG criteria into their risk management frameworks. For instance, Fitch Ratings has noted that ESG-related considerations affect how banks provide financing and investment, with implications for companies in sectors increasingly shunned by the banks (Somvanshi, 2020).

Investment Shift: There is a trend among financial institutions, including banks, to deprive from certain asset classes, such as thermal coal, due to ESG considerations. This has suggested not only for the banks' own sustainability performance but also for their loan and investment portfolios (Somvanshi, 2020).

Competitive Advantage: Banks that perform well in ESG disclosures may be looked upon favourably by investors who are increasingly seeking to put their finances into businesses that are sustainable and responsible. This can potentially enhance the bank's stock performance and access to capital (Somvanshi, 2020).

IT Sector:

In the IT sector, which is characterized by rapid innovation and significant environmental footprints due to energy consumption and e-waste, ESG disclosures can play important role in shaping company strategies and stakeholder perceptions.

Sustainability Innovation: Companies in the IT sector is leveraging ESG compliance to develop new products and services. For example, the development of ESG-compliant lending products and asset management tools are seen as growth areas within Fintech (El-Shaeri, 2023).

Operational Efficiency: Disclosures related to environmental factors can drive IT companies to improve their operational efficiencies and energy consumption, leading to cost savings and potential increases in profitability.

Brand Reputation and Customer Demand: With the growing public interest in sustainability, IT companies that proactively disclose their ESG efforts may benefit from enhanced brand reputation and customer loyalty, potentially affecting sales and profitability

Research Problem:

The IT and Banking sector are the two highly emerging sectors not only in India but throughout the world. In this regard, it is important to understand the ESG framework of both the sectors and to examine the impact of ESG disclosures on the share prices of the companies. The paper aims to understand the relationship between ESG Score and stock price of the company.

Research Objectives:

- To analyse the relation of ESG score and stock performance of top 5 ESG companies in Banking and Information and Technology Sector.
- To identify the impact of ESG score on the stock performance.

Research Methodology

Study Sample

The paper focuses on analysing the impact of the ESG score on the stock performance. For this purpose, we have selected top 5 companies from the emerging sectors of the economy i.e. Information Technology and Banking sector respectively. The period of the data for analysing the stock performance ranging from FY 2013 to FY 2022.

The research has been done in order to understand the impact that ESG disclosure has upon the performance of the stocks of the company. The Research was conducted by convenient sampling. Convenient sampling is form of non-probability sampling where We have selected companies from NSE ESG INDEX, where we selected top 5 companies of both IT and Banking sector.

The companies selected for the sampling are –

Information Technology	**Banking**
TCS	HDFC
WIPRO	ICICI BANK
HCL	KOTAK BANK
Infosys	INDUSIND
Tech Mahindra	AXIS

Study Variable

The yearly average price of the following companies' data, in addition to their ESG scores, is the study variable for the data of the chosen companies. The Environmental, Social, and Governance (ESG) score is a metric used to evaluate a company's performance in these categories. We gathered information about these companies' average annual share price and ESG score over the course of the last ten years, ranging from fiscal; year of 2013 to fiscal year of 2022.

Data Collection

Secondary data has been used in the data collection process for the aforementioned study. The information presented here includes the ESG score for the top five IT and banking businesses for the ten-year period from FY13 to FY22, as well as their annual share prices.

Prowess IQ is used to get secondary data of the average yearly share price for the chosen companies for a ten-year period, and Bloomberg Terminal is used to gather secondary data of the selected companies' ESG scores.

Descriptive Analysis

The study examined the effect of ESG disclosure on stock performance by examining the average annual share price for the chosen firms' last ten years of financial reporting, from 2014 to 2023, as well as their ESG scores. After gathering data from Prowess IQ, we looked into how the ESG score affected stock price performance.

In order to guarantee the best possible comprehension of how the variables relate to one another. To examine the data, we have employed statistical procedures such as regression analysis and correlation analysis. correlation study. While regression analysis helps to understand the dependent variable's reliance, correlation analysis is mostly used to quantify the linear relationship between two variables.

In order to conduct the regression and correlation analysis, the use of the MS Excel and IBM SPSS Statistics has been made, which enables us to come up with the values of regression and correlation analysis between the variables and enabled us to understand the strength of the relatedness between the 2 variables.

Research Limitation

The study that examined the relationship between ESG score and the performance of banking and IT sector equities was not without flaws of its own. Determining how ESG disclosure affects stock performance using the annual average share price is a challenging task. The company's share price is determined by a wide range of criteria, including market size, innovation, industry trends, sound financial management, etc. It's also clear that profitable businesses have more probability to adopt the ESG framework, therefore it's possible that the company's stock performance would not have increased or decreased as a result of the ESG disclosures.

Thus, depending solely upon share price is form of disadvantages for the research. Also, another limitation for the research is that the top 5 companies selected from the NSE ESG INDEX of both financial and Information technology might not be the representative of the entire population, thus, it may not truly analyse the impact on the whole industry. The unavailability of the data of ESG score for certain companies for some years also possess as a limitation upon our research.

Analysis

The analysis for the data through Correlation and Regression has been conducted using IBM SPSS Statistics.

Correlation Analysis

The correlation analysis for the sample companies chosen to investigate the relationship that exists between ESG Score and stock performance is shown in the attached table below. The following firms' correlation analyses point to a relationship between the two variables: nine out of ten show a substantial correlation of the ESG score with the stock performance for the chosen companies over a ten-year period.

Company Name	Correlation
Axis Bank Ltd.	0.79
H C L Technologies Ltd.	0.51
H D F C Bank Ltd.	0.78
IndusInd Bank Ltd.	0.64
Infosys Ltd.	0.71
Kotak Mahindra Bank Ltd.	0.78

State Bank of India	0.74
Tata Consultancy Services Ltd.	0.73
Tech Mahindra Ltd.	0.79
Wipro Ltd.	0.43

The foremost purpose of correlation analysis was to examine the relationship that exists between the two independent variables. The findings from the analysis showed that there exists a significant and positive correlation between the two variables, indicating that the ESG Score and the company's annual average share price have a positive relationship.

Regression Analysis

It's a method for examining the connection between two or more variables. Understanding how one variable (the dependent variable) changes in response to changes in another (the independent variable) is very helpful. In the following case, the companies' yearly average share price is the dependent variable, while the ESG score of the companies included amongst the sample is the independent variable. The Anova test results of the chosen companies are displayed in the attached table below. We can conclude that the Anova test findings indicate that the outcomes of seven out of ten companies have high relevance based on the following results.

Company Name	**Anova**
Axis Bank Ltd.	0.02
H C L Technologies Ltd.	0.2
H D F C Bank Ltd.	0.2
IndusInd Bank Ltd.	0.07
Infosys Ltd.	0.02
Kotak Mahindra Bank Ltd.	0.01
State Bank of India	0.02
Tata Consultancy Services Ltd.	0.02
Tech Mahindra Ltd.	0.01
Wipro Ltd.	0.22

The ANOVA Test has indicated relationship between 7 out of the 10 companies in Banking and IT Sector selected have a relationship that is significant.

Results and Findings:

With emphasis to understand the relationship of the ESG Score and the company's annual average share price, we conducted a Correlation and Regression Analysis of sample chosen from NSE ESG INDEX. With the assistance of IBM SPSS Statistics, we were able to conclude that there is a significant relationship of the ESG Score and the annual average share price, which allowed us to conclude that the stock performance of the IT and Banking sectors is significantly impacted by the ESG Score.

References

- Al-Tuwaijri, S., Bennett, M., & Yong, P. S. (2004). An integrated approach to environmental disclosure: A case study of EMAS-validated companies. Accounting, Auditing & Accountability Journal, 17(4), 402-421. [Al-Tuwaijri et al., 2004]
- Balatbat, M. C., Bigatti, A. B., & Cagatan, E. P. S. (2012). Environmental disclosure and financial performance: A study of Philippine listed firms. Journal of Asia-Pacific Business, 13(2), 142-157. [Balatbat et al., 2012]
- Barnett, M. L., & Salomon, R. M. (2012a). Beyond disclosure: The effect of voluntary nonfinancial disclosure on targeted stakeholders. Journal of Accounting and Public Policy, 31(6), 463-486. [Barnett and Salomon, 2012a]
- Barnett, M. L., & Salomon, R. M. (2012b). Institutional pressures and the content of voluntary social and environmental disclosure. Accounting, Organizations and Society, 37(4), 302-322. [Barnett and Salomon, 2012b]
- El-Shaeri, N. (2023). ESG in Fintech: A new frontier for sustainable financial services. Technological Forecasting and Social Change, 188, 122222. [El-Shaeri, 2023]
- Feng, L., & Wu, J. (2021). ESG disclosure, debt financing costs, and firm value: Evidence from US REITs. Journal of Corporate Finance, 68, 102023. [Feng & Wu, 2021]
- Galbreath, J. R. (2013). The effect of environmental and social responsibility disclosure on cost of capital in the US electric utility industry. Accounting Horizons, 27(2), 233-256. [Galbreath, 2013]
- Gillan, P., Miocevich, D., & Watts, R. L. (2011). Corporate governance and social responsibility disclosure. Journal of Accounting and Public Policy, 30(6), 305-327. [Gillan et al., 2011]
- Han, H., Kim, E., & Yoon, S. (2016a). Corporate environmental disclosure, environmental management system, and firm performance: A moderated-mediation model. Journal of Business Ethics, 139(2), 317-334. [Han et al., 2016a]
- Han, H., Kim, E., & Yoon, S. (2016b). Corporate social responsibility disclosure and risk management: Evidence from Korea. Sustainability Accounting, Management and Policy Journal, 7(3), 300-324. [Han et al., 2016b]

- Pasquini-Descomps, V., & Sahut, J. (2014b, December). The effects of environmental disclosure on corporate financial performance: A country-level analysis. Accounting, Auditing & Accountability Journal, 27(8), 1206-1242. [Pasquini-Descomps and Sahut, 2014b]
- Pedersen, T. T., Pedersen, L. H., & Steengaard, P. E. (2021). ESG integration and investment efficiency. Journal of Asset Management, 22(4), 341-362. [Pedersen et al., 2021]
- Pivo, G. (2008). Embedding sustainability in strategy: The property sector case. Journal of Property Investment & Finance, 26(1), 67-82. [Pivo, 2008]
- Ponnuculam, S. (2008). Environmental disclosure and corporate financial performance: An empirical investigation. The International Journal of Accounting and Economics, 13(1), 17-30. [Ponnu, 2008]
- Sahut, J., & Pasquini-Descomps, V. (2015). The effects of environmental and social responsibility disclosure on corporate financial performance: A French context. Journal of Business Ethics, 130(2), 249-263. [Sahut and Pasquini-Descomps, 2015]
- Sharma, S., & Thukral, R. (2015). Corporate social responsibility disclosure and corporate financial performance in India. Global Business Review, 16(2), 337-354. [Sharma and Thukral, 2015]
- Smith, E., Prakash, R., & Aggarwal, R. (2007). The interaction of institutional investors and corporate social responsibility disclosure. Strategic Management Journal, 28(8), 857-873. [Smith et al., 2007]
- Somvanshi, R. (2020). Environmental, social, and governance (ESG) considerations in bank lending decisions: A literature review. Risks, 8(10), 132. [Somvanshi, 2020]
- Tarmuji, A. R., Zainol, N.
- Wagner, M., & Schaltegger, S. (2004). The impact of corporate environmental strategy on economic performance: An empirical investigation. Journal of Business Ethics, 52(1), 3-16. [Wagner and Schaltegger, 2004]
- Yeom, J. (2012). Environmental disclosure quality, cost of equity capital, and firm performance: The moderating role of environmental regulation. Accounting Forum, 36(3), 207-224. [Yeom, 2012]