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Investigating the Relationship Between ESG Performanceand Market Capitalization

Namrata Kanwar, Komal, Saurabh Kumar, Jeetain Kumar, Reshav Dhiman

Under the Supervision of Dr. Ramadas KV

Master in Business Administration

Mittal School Business

LOVELY PROFESSIONAL UNIVERSITYPHAGWARA, PUNJAB

Abstract

This study investigates the potential connection between a company's environmental, social, and governance (ESG) performance and its market capitalization within the Indian context. Utilizing a scatter plot analysis of a large dataset encompassing 693 companies, the research revealed a weak negative trend between ESG combined score and market capitalization. However, the significant dispersion of data points across the plot suggested a more complex relationship. The analysis acknowledged the limitations of scatter plots, particularly their inability to account for the influence of other factors on market valuation. Factors such as company size, financial performance, industry affiliation, and economic conditions might be playing a significant role. Additionally, the observed data dispersion hinted at potential market mispricing, where companies with strong ESG practices might be undervalued by investors, and industry-specific effects, where the impact of ESG on market value could be stronger in certain sectors. To gain a deeper understanding of this intricate relationship, future research directions were identified. These included analysing correlations between individual ESG subcomponents and market capitalization to identify specific areas with a stronger association. Segmenting the data by industry could reveal industry-specific effects. Furthermore, employing regression analysis can offer a more robust understanding of the relative influence of various factors on market valuation. Finally, a long-term perspective might be necessary to capture potential delayed effects of ESG practices on market value. By addressing these limitations and exploring these avenues, future research can contribute to a more comprehensive understanding of the interplay between ESG performance and marketvaluation in the Indian market.

Introduction

The modern business landscape is witnessing a paradigm shift. Companies are no longer solely measured by their financial performance. Environmental, social, and governance (ESG) practices are rapidly becoming a critical factor influencing a company's reputation, social license to operate, and ultimately, its potential for success. This increased focus on ESG stems from a confluence of factors, including heightened environmental awareness, growing stakeholder demands for social responsibility, and concerns surrounding corporate governance. As investors and consumers increasingly prioritize responsible business practices, a crucial question arises: does a company's commitment to ESG translate into positive financial outcomes, specifically a higher market value?

The Rise of ESG and its Growing Importance

The concept of ESG has evolved significantly over the past few decades. Early discussions centered on corporate social responsibility (CSR) initiatives, primarily philanthropic endeavors or efforts to mitigate negative social and environmental impacts. However, the notion of integrating sustainability and ethical considerations into core business strategies has gained significant traction in recent years. This shift is driven by several factors.

Heightened Environmental Awareness: Growing public concern about climate change, resource depletion, and pollution has spurred pressure on businesses to operate more sustainably. Investors are increasingly factoring environmental risks into their analyses, recognizing the potential financial impact of climate change regulations or environmental disasters. Companies face pressure to reduce their carbon footprint, adopt renewable energy sources, and implement sustainable resource management practices.

Social Issues and Stakeholder Demands: Issues like labor rights, diversity and inclusion, and community engagement have also moved to the forefront. Socially responsible practices can enhance employee morale, brand reputation, and customer loyalty. Consumers are increasingly drawn to brands with strong ESG credentials, particularly those demonstrating fair labor practices, promoting diversity in the workplace, and fostering positive community relationships.

Governance Concerns: Corporate scandals have highlighted the importance of robust governance structures. Investors seek companies with strong ethical leadership, transparent practices, and effective risk management systems. Weak governance can lead to financial losses, reputational damage, and regulatory sanctions. Companies are responding by strengthening board oversight, implementing clear anti- corruption policies, and fostering transparency in communication.

The ESG Integration Movement and its Impact

This growing importance of ESG has led to the rise of ESG integration, where companies actively consider social, environmental, and governance factors in their decision-making processes. This can involve:

Developing Sustainability Strategies: Setting measurable goals to reduce environmental impact, improve resource efficiency, and mitigate climate change risks. This might involve investments in renewable energy, waste reduction initiatives, and circular economy practices.

Investing in Social Responsibility: Implementing ethical labor practices, promoting diversity and inclusion in the workforce, and engaging with local communities. This could involve fair compensation practices, safe working conditions, equal opportunity hiring, and community outreachprograms.

Enhancing Corporate Governance: Strengthening board oversight, implementing clear anti-corruption policies, and fostering transparency in communication. This involves establishing diverse and independent boards, implementing robust risk management frameworks, andproviding clear and accurate communication with stakeholders.

This integration of ESG considerations signifies a shift from shareholder primacy to stakeholder capitalism. Companies are increasingly recognizing that long-term success hinges not just on maximizing shareholder value but also on considering the impact on all stakeholders, including employees, communities, and the environment. A strong ESG commitment can foster a more sustainable and equitable business environment, ultimately contributing to long-term profitability and societal well-being.

1. Problem Statement

The growing importance of ESG practices necessitates a deeper understanding of their link to market value. Existing research, often using overall ESG scores, leaves a gap in analysing specific ESG subcomponents (environmental, social, governance) and their correlation with market capitalization using tools like Excel. Furthermore, the impact of company size on this relationship remains unexplored within correlation analysis. This research aims to address these limitations by investigating correlations between individual ESG metrics and market capitalization across different company size categories. By doing so, we can identify which ESG factors and company characteristics potentially influence market valuation based oninvestor perception.

2. Research Gap

One key gap lies in the need to refine the correlation analysis to identify which specific ESG factors might be most relevant to market capitalization. Most existing studies using correlation analysis likely examine overall ESG scores. However, a deeper dive into the correlation between individual ESG subcomponents (environmental, social, and governance) and market value could be highly valuable. This research would help us identify which aspects of ESG performance, such as strong environmental policies or high employee satisfaction, resonate most with investors and potentially influence market valuations. By utilizing Excel's functionalities for correlation analysis on these subcomponents, we can gain valuable insights even within the limitations of this tool.

Another gap within the context of correlation analysis exists in understanding potential variations based on company size. Limited research explores if the strength of the correlation between overall ESG score, and market capitalization varies depending on a company's resources and ESG focus. Analysing correlations for different company size categories within Excel can shed light on this aspect. This could reveal if larger companies with more resources are better positioned to demonstrate strong overall ESG performance, or if smaller, agile companies might be more innovative in specific ESG subcomponents, leading to a different impact on market valuation. By focusing on these two aspects, we can refine our understanding of the ESG-market capitalization relationship using correlation analysis in Excel.

3. Objectives

The objective of the research is to analyse the correlation between a company's ESG performance and its market capitalization. We will utilize established ESG rating systems or specific ESG metrics to measure a company's commitment to sustainability, social responsibility, and ethical governance. By analysing data on both ESG scores and market capitalization over a defined period, we aim to identify any statistically significant correlations. This will help us understand whether companies with strong ESG practices tend to have higher market valuations, suggesting a potential link between positive ESG performance and investor sentiment reflected in market capitalization.

Upon the initial analysis to refine our understanding of the correlation between ESG and market capitalization within the capabilities of Excel.
This will involve delving deeper into the data. We can explore correlations between individual ESG subcomponents (environmental, social, and governance) and market capitalization. This will reveal which aspects of ESG performance might have the strongest association with market value. Additionally, we can analyze correlations within specific industry groups. This will tell us if the relationship between ESG and market capitalization varies across different sectors. Finally, we can consider company size. Analyzing correlations for different company size categories might reveal variations in the relationship depending on a company's resources and ESG focus. By refining the correlation analysis in these ways, we aim to gain a more nuanced understanding of the specific ESG factors and company characteristics that potentially influence market valuation based on investor perception. This will provide valuable insights even while focusing on correlation analysis within Excel's capabilities.

4. Scope of the Study

This research focuses on the relationship between a company's environmental, social, and governance (ESG) practices and its market capitalization. Market capitalization, calculated by multiplying a company's share price by the total number of outstanding shares, serves as a key indicator of a company's overall financial health and investor confidence.

Our primary objective is to investigate whether strong ESG practices, as measured by established ESG rating systems or specific ESG metrics, have a positive impact on a company's market capitalization. This analysis will involve examining the correlation between ESG scores and market capitalization over a defined period. Additionally, we will explore potential causal connections. Does a company's commitment to sustainability, employee well-being, and ethical operations lead to increased investor confidence and ultimately a higher market value? Or is the relationship the other way around, where companies with greater financial resources are better positioned to invest in ESG initiatives?

Furthermore, we will consider potential moderating factors that might influence the ESG-market capitalization relationship. These could include industry-specific considerations, such as the environmental impact of different sectors. Company size might also play a role, as larger companies may have more resources dedicated to ESG initiatives. Additionally, we will investigate if a company's level of ESG disclosure, measured by the transparency and comprehensiveness of its sustainability reports, has any bearing on its market value. By addressing these aspects, this research aims to contribute to a deeper understanding of how ESG practices influence a company's financial standing and investor perception.

5. Literature Review

In today's business environment, it is important to examine the connection between environmental, social and governance (ESG) practices and department performance. This review examines existing research to understand how a company's ESG efforts, including sustainability, treatment of employees, and employment equity, impact financial success. We'll take a closer look at the relationship between ESG and metrics such as income, return, and risk. We will also explore theoretical perspectives that explain how strong ESG practices, such as attracting talent and mitigating risk, can improve performance. The key question to address is cause and effect: Do strong ESG practices lead to financial success, or do wealthy companies have more resources to spend on ESG measures? This analysis focuses on the perspective of this relationship involving specific businesses, stakeholders and the resulting ESG investments, ultimately resulting in a relationship; Discusses the role of ESG in business strategy and responsible investment.

Guang you Zhou (2022), Lian Liu (2022), conducted research on Sustainable development along with ESG performance and company market value. This paper shows the sustainable development of the economy attracts more attention. Particularly in the context of the ongoing financial crisis and the COVID-19 pandemic, how the environmental, social and governance (ESG) performance of listed companies can affect the company's market value has received intense attention. Different from existing studies, this paper uses financial performance as a mediator and builds a horizontal model and mediation model based on analysing the relationship between ESG performance, financial performance, and business performance-related processes. More research shows that the ESG performance of state-owned companies has a positive impact on employee performance. Finally, the article provides recommendations for regulators, listed companies, and investors. Danny Z. X. Huang (2019) conducted research on why companies engaged in environmental, social and governance (ESG) activities last and thrive. This article examines alternative explanations for this relationship and finds that the weight of evidence suggests a strong, positive but small commercial ESGP-CFP link, to be pursued where necessary. This business relationship suggests that ESG performance is unlikely to be driven by narrow CFP metrics. Ganlin Pu (2022) conducted research on an informal assessment of the relationship between ESG and corporate performance: Evidence from China. The main purpose of this article is to identify the gap between ESG activities and firm performance in emerging markets. Analysis of 232 listed Chinese companies shows a positive relationship between ESG activities and company performance. However, this relationship is not linear. In other words, the relationship between ESG activities and company performance is in an inverted U shape. This suggests that the relationship is positive until it reaches a threshold, when ESG performance exceeds the threshold, it begins to have a negative impact. The main insight of this study is that companies need to find the starting point for their ESG activities to get the maximum benefit from these activities. Imlak Shaikh (2022) conducted research on Environmental, Social and Governance (ESG) Performance and Quality: International Evidence. This article attempts to provide further evidence of the company's business reporting on sustainability in terms of disclosure of non-financial interests. These reports are derived from annual reports, Corporate Social Responsibility (CSR) and the Global Reporting Initiative (GRI). Descriptive and inductive statistics show that the ESG compliance of European companies is more pronounced. At the same time, Asian companies are more disciplined in the energy sector, while those in the Asia-Pacific region are more focused on technology companies. Research shows that there is a significant difference in business performance (ROA and ROE) and business profitability (Tobinâs-Q) between GRI and non-GRI companies. Alexandre S. Garcia, Wesley Mendes-Da-Silva, and Renato J. Orsato (2018) conducted research on corporate sustainability, capital markets and ESG performance. This chapter discusses the link between a company's financial health and its environmental, social and governance (ESG) performance, considering companies in Brazil, Russia, India, China, and South Africa (known as BRICS). Our results show that market capitalization is an important indicator of ESG performance. Larger companies have higher productivity. We also find that firms in sensitive industries demonstrate environmental performance even when controlled for size and country. Our results shed light on future research on ESG performance. Silvia Carnini Pulino, Mirella Ciaburri, Barbara Sveva Magnanelli and Luigi Nasta (2022) Although ESG disclosure affects corporate performance. Given stakeholders' concerns regarding corporate ESG practices, this study focuses on analysing the impact of environmental, social and governance (ESG) on the company's operations. This study found a positive relationship between environmental, social and governance disclosures and corporate performance as measured by earnings before interest and taxes. Our findings will help stakeholders, decision-makers, policymakers, and researchers improve their understanding of the impact of ESG disclosures, such as shared or personal identification via mail, on corporate business performance. The findings support the positive relationship between ESG disclosures and firm performance, encouraging managers to invest in CSR practices. Junius, D., Adisurjo, A., Rijanto, Y.A. and Adelina, Y.E. (2020) conducted research on the impact of ESG performance on company performance and market value. This study aims to investigate the impact of ESG performance on company performance and market value. The study found that ESG scores do not have a significant impact on company performance and market value because ESG scores have not yet become part of the company's performance evaluation. The study was limited to research on business results with only a one-year business period and a small number of companies with existing ESG scores. VOCHENKO, Denys and XU, Qing and KENDO, Sandra (2024), conducted the research on the impact of ESG factors on corporate investment. This article uses multiple regression methods to examine the relationship between capital markets and environmental, social and governance (ESG) scores. The results of this study provide a deeper understanding of the economic impact of leadership and have important implications for the business decisions of investors, policymakers, and the public. Bahaaeddin Ahmed Alareeni, Allam Hamdan (2020), The impact of ESG on the performance of American companies listed in the S&P 500 Index. This article examines whether there is a relationship between business environment, social and governance (ESG) reporting and economic (ROA), financial

(ROE) and market (Tobin's Q) and whether these relationships are positive or negative, or even aims to investigate relationships. natural. sex. The results show that ESG exposure has a positive impact on the company's performance evaluation. However, measuring ESG subcomponents separately shows that environmental (EVN) and corporate social responsibility (CSR) show negative effects on ROA and ROE. EVN and CSR showed positive results for Tobin's

Q. Jean-Michel Sahut and Hélène Pasquini-Descomps (2015), conducted research on the impact of ESG on business performance: international evidence. This study examines how news based ESG (environmental, social and governance) scores affected monthly stock returns in Switzerland, the United States and the United Kingdom between 2007 and 2011. Finally, our nonparametric core regression highlights the position that attributes the stock to changes in the market. ESG score can be inconsistent. Bohyun Yoon, Jeong Hwan Lee and Ryan Byun (2018), Does ESG Performance Increase Firm Value? Evidence from South Korea. We analyse whether corporate social responsibility (CSR) plays an important role in increasing corporate value in South Korea, an emerging market. We use environmental, social and governance (ESG) scores to measure CSR performance and analyse its impact on companies' business performance. This study contributes to the general literature by validating the quality of CSR social analysis in emerging markets, which provides important policy and social implications for businesses where government plays an important role in promoting CSR. The benefits of chaebol social responsibility are strong, and this may provide the economic background for the Korean government to intervene in chaebol reform. Raisa Almeyda, Asep Darmansya (2019), The impact of environmental, social and governance (ESG) disclosures on financial markets. The purpose of this study is to analyse and present the non-financial factors affecting the financial performance of the company, which will show the company's ESG (Environmental, Social, Governance) score. The results showed that there is a significant relationship between ESG disclosure and corporate ROA and ROC, but there is no relationship between stock price and P/E. We also find that environmental conditions have a significant relationship between companies' ROC and stock. Price: % p. Finally, the research also shows that there is no relationship between management and relationship with the performance of financial institutions. The results show that high transparency of ESG information improves financial performance. Therefore, investors, company management, policy makers and business regulators should consider the importance of ESG disclosure. Amal Aouadi and Sylvain Marsat (2018), Does ESG conflict affect firm value? Evidence from international literature. The purpose of this article is to investigate the relationship between environmental, social and governance (ESG) conflicts and corporate value. Separate sampling shows that higher CSP scores only affect the market value of high-income companies in countries that are larger, more efficient, have more independence, and have more research and analysts on the Internet. For companies that pay them more, their company's social reputation continues to improve. Our findings therefore provide new insights into the role of business vision that companies can leverage from their CSPs.

Recent research explores the intricate link between a company's environmental, social, and governance (ESG) practices and its financial performance. Studies suggest a positive correlation between strong ESG and factors like market value and profitability. However, one study proposes a non-linear relationship, where excessive ESG efforts might have diminishing returns. Additionally, regional variations exist, with some companies focusing on social aspects or specific sectors like energy or technology. Interestingly, transparent ESG reporting practices might be associated with better business performance. Finally, research suggests a link between a company's size and its ESG performance, withlarger companies potentially demonstrating stronger ESG practices.

6. Methodology

This research delves into the potential relationship between a company's environmental, social, and governance (ESG) performance and its market capitalization within the Indian context. Utilizing a substantial dataset encompassing 693 companies, the analysis explored the connection between these two factors.

6.1 Key Findings and Interpretation:

The analysis revealed a correlation coefficient of **-0.0458** between ESG score and market capitalization. While statistically significant due to the large sample size, the weakness of the correlation necessitates a cautious interpretation. A coefficient close to zero indicates a very weak linear relationship, suggesting that changes in a company's ESG score are not necessarily accompanied by significant changes in its market capitalization. The negative sign (-0.0458) hints at a very slight tendency for companies with higher ESG scores to have lower market capitalization. However, the weakness of the correlation makes it difficult to establish a definitive causal relationship.

6.2 Benefits and Limitations of Spreadsheet Software Analysis:

The initial analysis employed readily available spreadsheet software, offering a convenient first step. This approach allowed for an initial assessment of the presence and direction of a potential relationship between ESG and market performance. The large dataset (693 companies) strengthens the analysis by providing a more reliable indication of the overall association, even with a weak correlation.

However, it's crucial to acknowledge the limitations inherent in this approach. Correlation does not imply causation. Other factors, such as industry performance, company size, or economic conditions, might be influencing market capitalization. Additionally, the quality and consistency of data from various online sources can impact the correlation. Furthermore, spreadsheet software, while a useful tool, may have limitations in advanced statistical analysis. Techniques like regression analysis could be employed to explore potential causal relationships and control for other influencing factors.

6.3 Alternative Interpretations and Further Research Directions:

The weak negative correlation observed could suggest potential market mispricing in the Indian context. Companies with strong ESG practices might be undervalued by investors who don't fully recognize the long- term benefits of ESG commitment. Further research could investigate this possibility.

Another important consideration is the potential for industry-specific effects. The overall weak correlation might mask stronger relationships within specific sectors. Analyzing correlations within industry groups could reveal if ESG has a more significant impact on market capitalization in environmentally sensitive industries or those with a strong focus on social responsibility.

Company size is another factor to consider. Smaller companies might be more agile in implementing specific ESG practices, potentially influencing their market value differently than large corporations. Exploring correlations across different company size categories could provide valuable insights.

The long-term perspective is also critical. ESG benefits might not be immediately reflected in market value. Analyzing correlations over a longer timeframe (if data permits) could capture potential delayed effects on market capitalization.

6.4 Refining the Analysis for a More Nuanced Understanding:

To gain a deeper understanding, future research could analyze the correlation for individual ESG subcomponents (environmental, social, governance) to see if specific aspects have a stronger association with market capitalization in the Indian market.

The weak negative correlation between ESG and market capitalization, based on this large dataset analysis, highlights the need for further investigation. Considering industry effects, company size, and potential market mispricing specific to the Indian market is crucial. By employing more advanced statistical tools and refining the analysis, future research can provide a clearer picture of the potential connection between ESG practices and market valuation in India.

6.5 Possible Outcomes:

Future research could lead to several possible outcomes:

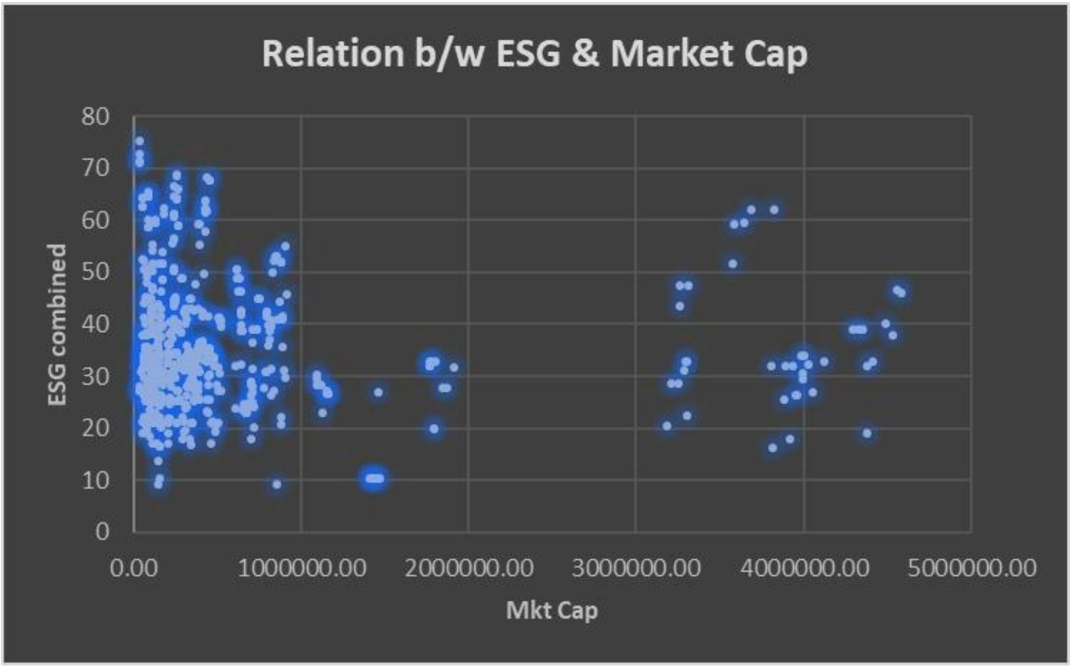
6.5.1 Identification of a Stronger Relationship: A more refined analysis might reveal a stronger, positive correlation between specific ESGsubcomponents and market capitalization in certain sectors.

6.5.2 Confirmation of Market Mispricing: Research could provide evidence of potential market mispricing, suggesting that companies withstrong ESG practices are undervalued in the Indian market.

6.5.3 Need for Long-Term Analysis: The study might highlight the need for long-term analysis to capture the delayed effects of ESG practices onmarket value.

These possibilities underscore the importance of further research in this area to gain a comprehensive understanding of the complex relationshipbetween ESG performance and market capitalization.

6.6 Graphical Representation



6.6.1 Interpretation

The scatter plot reveals a weak negative trend, suggesting a potentially limited association between a company's ESG combined score and its market capitalization. The data points exhibit considerable dispersion, indicating that changes in ESG score are not necessarily accompanied by significant changes in market value. Companies with high market capitalization can have a wide range of ESG combined scores, and vice versa. This dispersion suggests that other factors besides ESG performance might be significantly influencing market valuation.

Furthermore, the presence of potential outliers (data points far from the main cluster) warrants further investigation. Examining these outliers could reveal valuable insights into companies with exceptionally highESG scores despite low market capitalization or vice versa.

6.6.1.1 Possible Explanations and Further Research:

Several explanations could account for the observed weak correlation and data dispersion. Market mispricing might be a possibility. Companies with strong ESG practices might not be fully recognized by investors in terms of their long-term value proposition, leading to a disconnect between ESG score and market capitalization.

Industry effects could also be at play. The overall weak association might mask stronger relationships within specific industries. For instance, companies in environmentally sensitive sectors or those with a strong focus on social responsibility might show a clearer positive correlation between ESG and market capitalization. Further analysis segmenting the data by industry could shed light on these potential industry-specific effects.

Unobserved factors not captured in this scatter plot analysis, such as company size, financial performance, or overall economic conditions, could also significantly influence market capitalization.

6.6.1.2 Limitations of the Scatter Plot Analysis:

It's important to acknowledge the limitations inherent in scatter plot analysis. This type of visual representation only reveals the relationship between two variables (ESG score and market capitalization in this case). Scatter plots don't account for the influence of other factors that might be affecting market valuation. Additionally, the accuracy and comprehensiveness of the data used to generate the plot can impact the analysis. The scatter plot suggests a weak relationship between ESG combined score and market capitalization in the given dataset. While the data dispersion indicates the influence of other factors, further analysis is needed to understand the complex interplay between ESG performance and market valuation. By incorporating additional variables, considering industry effects, and potentially using regression analysis, future research can provide a more comprehensive understanding of how ESGpractices influence a company's market value.

6.7 Conclusion

This analysis sets out to explore the relationship between a company's ESG combined score, a measure of environmental, social, and governance performance, and its market capitalization. The investigation utilized a scatter plot visualization, revealing a weak negative trend and significant data dispersion. While initially suggestive of a potential negative association between ESG and market value, the analysis acknowledged limitations inherent in scatter plots – their inability to account for the influence of other variables that might be affecting market valuation.

The observed data dispersion highlights the complexity of the relationship between ESG performance and market capitalization. Other factors, such as company size, financial performance, industry affiliation, and overall economic conditions, could be significantly influencing market valuation. Furthermore, potential market mispricing and industry-specific effects warrant further exploration. A company with a strong ESG score might not be fully recognized by investors in terms of its long-term value proposition, leading to a disconnect between ESG and market capitalization. Additionally, the impact of ESG practices on market value might be more pronounced in certain industries, such as those environmentally sensitive or with a strong social responsibility focus. To gain a more comprehensive understanding of this complex relationship, future research should consider incorporating additional variables and employing more advanced statistical techniques. Analyzing correlations between individual ESG subcomponents and market capitalization could reveal specific aspects with a stronger association with market value. Segmenting the data by industry and analyzing correlations within different industry groups could shed light on industry-specific effects. Furthermore, employing regression analysis can provide a more robust understanding of the relative influence of various factors, including ESG score, on market valuation. Finally, a long-term perspective might be necessary to capture potential delayed effects of ESG practices on market value, as the benefits of strong ESG performance might not be immediately reflected in market capitalization. By addressing these limitations and exploring these avenues, future research can contribute to a more nuanced understanding of the interplay between ESG performance and market valuation.

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