FINANCIAL PERFORMANCE OF INDIAN COMPANIES IN RELATION TO THEIR ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG) RATINGS

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ABSTRACT
Sustainability has become a robust demand for government, industries and every stakeholder who aims to drive the nation and economy forward. "ESG," for "Environmental, Social, and Governance," evaluates a company's moral impact on the triple bottom line and is a subset of sustainable investments. ESG ratings and indicators are simply a combination of investing and sustainability. Institutional investors and the companies they back have shifted their focus from maximising short-term shareholder gains to minimising the negative effects of their actions on society at large. So, this study aims to reveal the connection between Indian companies' ESG ratings and their financial performance. The study used an exploratory research approach. The ProweissIQ, as well as the yearly reports, were utilised in order to compile the 75 observed sample data from the Top 15 NSE firms over the course of five years. In contrast, five years of ESG scores for the chosen corporations have been gathered from MSCI (2018-22). SPSS software was used to conduct analyses using descriptive statistics, Pearson correlations, and regression analysis, which revealed a favourable connection between individual scores of Environment, Social & Governance ratings and company profits.
Keywords: Environment, Social & Governance ratings, ESG, Financial Performance, Sustainability

Introduction

Phil Harding once stated, "We have two options in the 21st century: either we can take care of our planet, and it will take care of us, or we can do nothing and suffer the consequences." Earth and ecosystem balance must be maintained for future generations. As the saying goes, when opportunity grows, it brings challenges like natural disasters such as pollution effects, climate change, waste management, drought, pandemics or tsunamis, which have become afflictions in history (Merchant, 2022). No economy can grow and achieve future development with this affliction of natural resources. Sustainability has become a vital demand for government, industries and every stakeholder who aims to drive the nation and economy forward.

Sustainability is more than a phrase or jargon; it is a fundamental motivator for conquering the grim future. ESG ratings and indicators are simply a combination of investing and sustainability. In 2005, 'Who cares wins' was published by the UN and coined the term ESG initially, which measures sustainability and predicts firms' financial performance (Sridharan, 2022). Sustainable investments, known as "ESG" (Environmental, Social, and Governance) evaluate a company's moral impact on its most important constituencies. (2021, Nishit Desai Associates). Socially screened financial goods have built a booming industry in most industrialised nations. Governments are gradually adding ESG requirements with tight business compliance to their legal frameworks. Carbon emissions, greenhouse gas emissions, biodiversity, water efficiency, depletion of resources, raw material sources, waste and pollution management, and water efficiency are all environmental factors that need to be considered (Sridharan, 2022). The company's public or political stance on human rights issues should be based on things like its social ties, the safety of its products, and what its customers want (Nishith Desai Associates, 2021). Governance is the process of setting up rules and procedures to ensure that everyone involved in a business—the board of directors, the management team, the shareholders, and the wider community—exercises the duties and rights that are theirs (Nishith Desai Associates, 2021).

ESG investing is becoming increasingly important, with compliance reports increasingly crucial in determining the investment's long-term sustainability. It's now necessary to measure company sustainability. Last year, all European and non-European investment firms had to consider ESG in their investing decisions (Chatterji, 2022). Sustainable economies have flourished worldwide, including in India. Many companies in India started reporting on sustainability performance since most stakeholders are interested in environmental and societal issues and challenges. (Pham,2022). Few studies in India show the relationship between an organisation's ESG score and financial performance.

Literature Review
(Chelawat & Trivedi 2016) found that using panel regression models, a well-established relationship exists between the ecological, societal, and governance (ESG) performance of the corporate sector and the fiscal performance of the industry.

(Nor, Bahari, Adnan, Kamal, and Ali 2016) the study aimed to find out how environmental disclosure affects the performance of Malaysia's top 100 businesses. A content analysis was performed on this study's annual report from 2011.

Still, no statistically significant association exists between ROA, ROE, or EPS and exposure to the whole environment. One possible problem could be that Malaysian businesses must have the rules and legal requirements to say they are environmentally sustainable. In addition, environmental disclosure in Malaysia is still in its infant stages, although it is gradually developing because most firms are already aware of environmental challenges.

(Rajesh and Rajendran 2018) the empirical data about the link between ESG ratings and how well businesses do regarding sustainability, they tracked and rated the ESG performance ratings of 1,820 corporations worldwide over five years, from 2014 to 2018. They focused on ten main topics and more than 400 indicators from Thomson Reuters and Bloomberg terminal data. The study utilised bootstrapping analysis using SmartPLS 3.0 software to direct and moderate effects on sustainability performances. This analysis and software provide evidence of the natural and moderating effects.

Jonsdottir (2022) the elements that influence the usage of ESG data in investment choices. According to the survey findings, many institutional investors are concerned about the reliability of using ESG data because of the poor quality of such data. Interviews with experts from publicly listed firms, rating agencies, and institutional investors are carried out in a semi-structured format.

According to the research findings, ESG data quality can be divided into four categories: data quality, correctness, dependability, and comparability. The practical consequences of transacting with carbon credits generate issues concerning the firms' ESG data disclosures to combat the lack of quality in ESG data. This is necessary to find a solution to the problem.

Stakeholders Theory
The sustainability report and concept of ESG developed from the stakeholder theory, written by R. Edward Freeman in 1984 (Velte, 2017). Under stakeholder theory, anyone affected by the organisation’s doing should be taken as a stakeholder; it may be investors, shareholders, employees, communities, citizens, etc.

Theory of legitimacy
The legitimacy theory states that organisations should function by considering societal constraints and standards (Deegan 2002).

The Theory of the Triple Bottom Line
The concept of “triple bottom line” was coined by John Elkington in 1994 to express the way of measuring a company’s financial performance sustainably by involving the people’s well-being and ecological resources.

Statement of the problem
SEBI requires 1,000 listed companies to send in Business Responsibility and Sustainability Reports (BRSR) (Warsia, 2022) that include ESG factors to promote climate-resilient development. The companies must share the ESG report and a plan for reducing risks to meet the sustainability goals. Over the past ten years, sustainable finance, CSR reports, and ESG ratings have become more critical to investors. Sustainability reporting ensures everything is clear and works well in the fast-paced world of branding and building a good reputation; sustainability reporting ensures everything is clear and works well. It also measures the effects of future investment decisions. To make a sustainable portfolio, many stakeholders try to link the company's past performance with its sustainable practices. So, the current research focuses on determining how ESG scores affect how well Indian companies do financially.

Need and importance of the study
The growing number of organisations that are using ESG indicators in their reported statements or using them as a standard in documents demonstrates an excellent response. The ESG score has made room for environmental and sustainable concerns in corporate decision-making, which was previously limited to the traditional "triple

bottom line" of profit, people, and the planet. Essential factors in the investing process now include ESG measures and analyses. The future of ESG and sustainability studies holds tremendous promise. The ESG research will aid many investors as a guiding tool for portfolio selection, and the current study will explore the influence that ESG scores have on the financial performance of Indian firms. Several investors will benefit from the ESG research. ESG investors are more interested in developing long-term value over a multi-year period rather than being concerned in short-term financial gains. This is good for a firm in making bankable ties with its investors because ESG investors are more interested in generating long-term value over a multi-year period (Nishith Desai Associates, 2021).

Research Gap

Financial performance and ESG scores, ESG framework elements, sustainable investment, and investment decision-making have all been the focus of prior research (Magnér, 2020; Pulino 2022). Additionally, several studies have discovered a correlation between ESG ratings and profits. However, evidence linking ESG ratings to financial performance is less robust, especially for Indian enterprises. Hence, the current research examines the relationships between the top 15 NSE firms' ESG ratings and their financial success over the past five years (through 2022).

Primary Objectives

- To analyse the relationship between ESG scores and financial performance.

Secondary objectives

- To investigate the association between environmental score and financial success.
- To determine the relationship between social scores and financial performance.
- To examine the link between governance score and financial performance.

Research Hypothesis

H1: There is an affirmative association between ESG ratings and company financial performance.
H2: There is a positive association between the environmental score and the company's financial performance.
H3: There is an affirmative relationship between a company's social score and its financial performance.
H4: There is an affirmative relationship between a company's governance score and its financial performance.

Limitations of the study

- The study sample focused on India's Top 15 NSE companies for five years,
- To measure a company's financial success, the return-on-assets ratio, the return-on-equity ratio, the price-to-earnings ratio, and the price-to-book value ratio are used. Any other variables that may impact a company's financial performance are disregarded.
- The current study focuses on limited data due to time constraints.

Proposed Framework

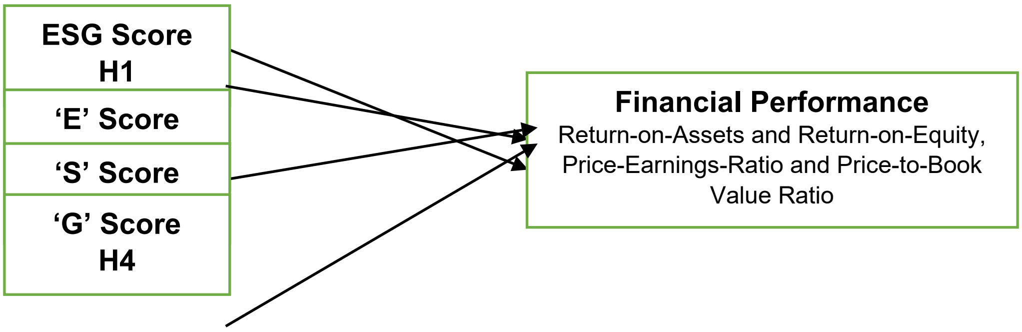


Figure 1

Methodology

This study used an exploratory approach to research. The data was collected using the database stream and yearly reports, with the current study concentrating on the top 15 firms listed on the NSE website over the course of five years, using 75 observations. In contrast, data on ESG scores for the selected companies have been obtained from MSCI (ESG Database Company) for five years (2018-22). And the financial statements extracted from the selected companies' annual reports, ProweissIQ, and other reports for collecting the news about companies and sustainable practices. Statistical tools like Excel & SPSS statistical packages were used in the study for analysing data. The price-earnings ratio, the price-to-book value ratio, the return on assets, and the return on equity would be used to measure a company's financial health. these financial ratios provide insight into a company's profitability, efficiency, and valuation, which are essential for investors to consider when making investment decisions.

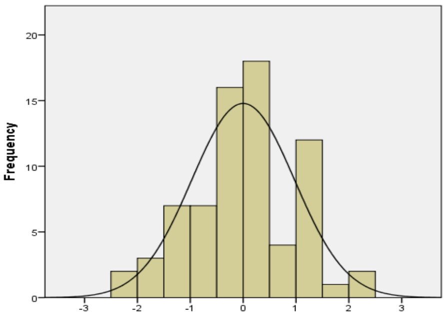
Empirical Analysis
The normality test on the observed variables is shown in Figures 1 and 2 below. The bare statistics sample of the study is presented in Table 1. These data comprise the mean value as is (0.9640 hectares of standard deviation). The average ESG score is 45.26389, with a social rage rating of 0.9640. The social score is the essential value of the three ratings, especially when contrasted with the other two values. It is necessary to note that in the scores, the standard deviation of the environmental score is more significant than that of the social and governance score.

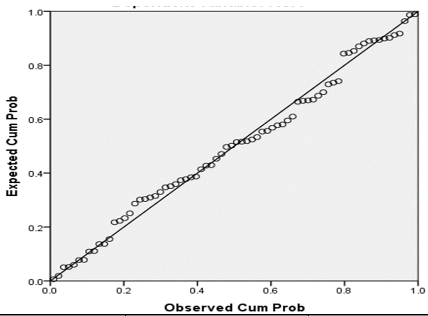
Figure 1 and Figure 2 shows the Normality of the data.

Variables	**Mean**	**Standard Deviation**
ROA	.09640	.104720
ROE	.18111	.164664
P/E	66.30125	216.184748
P/B	6.80319	9.843715
ESG Score	45.26389	20.203188
ENV_Score	40.85347	25.668555
SOC_Score	46.17208	20.010327
GOV_Score	42.6190	19.42840
Overall FP	18.3455	53.97789

Table 1 Descriptive Statistics

Table 3 displays the Pearson correlation coefficients with two tails. A corporation's environmental, social, and governance ratings strongly correlate with its financial performance. Companies' performance increases when they submit their E, S, and G statistics. Nevertheless, we only find a significantly unfavourable association between the total ESG score and the firms' financial success.





Variable	**Overall FP**	**ESG_Score**	**E_Score**	**S_Score**	**G_Score**
Overall FP	1.000				
ESG Score	-.172 (.074)*	1.000			
ENV_Score	.929 (.000)***	-.164 (.084)*	1.000		
SOC_Score	.797 (.000)***	-.015 (.449)*	.898 (.000)***	1.000	
GOV_Score	.943 (.000)***	-.197 (.049)**	.934 (.000)***	.858 (.000)***	1.000

Table 2 Pearson Correlation Matrix
Note: *, **, and ***- indicate the level of significance at 10%, 5%, and 1%.

The R-value in Table 3 is 0.921, which shows a solid affirmative relationship between each business's ESG score and its financial success on the NSE. Based on the R2 value, the relationship between the two variables is so strong that it explains 96% of the total variation in the dependent variable. The remaining 4% of the correlation's spread may be due to factors outside of it, such as the size of the firms, their total debt, and how much leverage they use. Because the p-value is lower than 0.001 at the 1% significance level, the null hypothesis (H0) has been disproved, while the alternate Hypothesis (H1) has been accepted. This shows that individual scores of 'E' and 'G' benefit the company's financial success. On the other hand, a negative correlation has been demonstrated between social scores and financial success. The p-value for the social score is lower than 0.001 at a significance level of 1%. The total ESG score has a detrimental impact on the company's overall financial success. Hence, the null hypothesis cannot be accepted at a significance level of 10%.

Model	**Unstandardised Coefficients**		**Standardised Coefficients**	**t**	**Significance**
	B	**Standard Error**	**Beta**		
Overall FP	-3.818	2.099		-1.819	.073*
ESG Score	.093	.073	.047	1.278	.206*
E_Score	.561	.109	.583	5.124	.000***
S_Score	-.215	.063	-.284	-3.427	.001**
G_Score	.633	.095	.652	6.639	.000***
R2	.960				
R-Value	.921				
Adjusted R2 Value	.916				
f-Value	195.70				
p-Value	0.000				

Table 3 Regression Analysis
Note: *, **, and ***- indicate the level of significance at 10%, 5%, and 1%.

This study may raise ESG awareness among Indian companies. Awareness will boost investment for the organisation. This study is essential to many different groups because it will help them improve their living standards and overall quality of life in different ways (from environmental, social, and governance points of view). For instance, the findings of this study could help policymakers make informed decisions on resource allocation and development planning. At the same time, businesses could use the insights to improve their sustainability practices and enhance their reputation among consumers. Additionally, individuals and communities could benefit from the study by better understanding how their actions impact the environment and society and how they can contribute to positive change.

Conclusion

The results indicate the positive impact of the ESG rating on the financial performance of the top 15 companies traded on the NSE between 2018 and 2022. The analysis shows a link between the individual scores for environment and governance and the firm's financial success. The other side of the analysis shows that the social and ESG-related aspects do not have the same effect. In summary, the findings of this study shed light on the limited previous work that has been done on environmental, social, and governance rating (ESG rating). This shows the importance of considering ecological, societal and corporate governance factors and financial performance when making financial and speculation decisions. Including other variables related to performance mechanisms that could affect a company's economic performance would be good. Further, the study sample focused on India's top 15 NSE companies for five years. In addition, only a few factors were considered, such as return on assets, return-on-equity, price-to-earnings ratio, and price-to-book value. Because of time restrictions, the present study concentrates on a small amount of the available data. The practical issue that every stakeholder needs to be aware of is that transactions with carbon credits generate problems concerning the firms' ESG data disclosures to conflict with the poor ESG data quality. This is necessary to find a solution to the problem. One possible solution is establishing a standardised framework for ESG data reporting and verification, increasing transparency and consistency across the industry. Additionally, collaborating with firms, regulators, and other stakeholders could help identify best practices and address challenges related to carbon credit transactions and ESG data quality.

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