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The Financial Impact Of Incorporating Environmental, Social and Governance Performance Indicators Into Capital Investment Hiring

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Abstract:

As the concept of sustainable development deepens, academics are beginning to recognize the financial impact of environmental, social,and governance (ESG) performance on capital investment. This article examines the financial impact of incorporating ESG into capital investment hiring by examining real-world cases and literature. Based on the findings, this article recommends that companies incorporate ESG indicators into capital investment hiring to promote green innovation. Investors should also integrate ESG and revise traditional valuation models. This article proposes that the quantitative characteristics of ESG (such as carbon emissions data) are more applicable to investment decisions in the capital market. Furthermore, this article's industry analysis shows that environmental performance (E) in the manufacturing industry has the most significant financial impact, while governance performance (G) in the financial industry is even more critical. This research provides a theoretical framework for balancing ESG investment and financial objectives and points to the need for further empirical analysis of the dynamic effects of ESG using long-term panel data.

Keywords: ESG performance; capital investment; executive incentives; enterprise digital transformation.

1. Introduction

Currently, Environmental, Social, and Governance (ESG) investment strategies are still in their infancy in China's capital market, and many investment institutions are exploring their feasibility in practice. However, although the ESG concept has gradually been recognized by investors and companies, their actual investment willingness and implementation efforts are still limited. The core issue that restricts the vigorous development of ESG investment is the lack of relevant information disclosure, which makes it difficult for investors to obtain comprehensive and reliable data to support decision-making [1].

In this context, it is crucial to establish a scientific and unified ESG performance indicator rating system. ESG ratings provide investors, companies and other stakeholders with a vital decision-making basis by quantifying and evaluating the performance of companies in environmental, social and governance dimensions. It not only helps to identify and manage non-financial risks, but also reveals long-term value drivers and potential growth opportunities that are ignored by traditional financial analysis. The academic community generally believes that a reliable ESG rating system can effectively alleviate market information asymmetry, reduce capital costs, and that good ESG ratings can improve corporate performance [2]. Since 2023, our country's ESG investment field has continued to develop rapidly. While financial institutions are laying out the ESG market, they are also promoting the continuous growth of the number and scale of ESG-related products and services. This is no longer an isolated situation, because our regulatory policies are no longer just affected by overseas policies. China's ESG investment environment has also made significant improvements under the guidance of regulatory policies, attracting more and more institutional investors to participate. This trend highlights the increasing status of ESG ratings in market practice. Many scholars have conducted in-depth discussions on the relationship between ESG and corporate performance. Mainstream research believes that good ESG performance can positively affect financial performance through various channels. For example, Yang Ruibo et al. pointed out that excellent ESG ratings can send positive signals to the market, enhance corporate reputation, thereby obtaining a more relaxed financing environment and ultimately improving financial performance [2]. Li Jinglin et al. demonstrated the promoting role of ESG from the perspective of corporate innovation, believing that ESG practices can provide resources and support for innovation activities by increasing Research and Development (R&D) investment and attracting outstanding talents, ultimately improving corporate competitiveness and operating performance [3]. In addition, Yan Weixiang et al. found that ESG ratings can help reduce agency costs and improve risk management, thereby having a positive impact on the financial performance of listed companies [4]. Based on the above research background, this paper aims to explore a more operational frontier issue: whether and how to incorporate ESG performance indicators into capital investment and hiring (i.e., investment decisions and executive incentive contracts) to produce financial impacts. The significance of this research is to enable employees, companies, investors and the entire society to truly benefit from ESG. For companies, this research can help them settle their long-term ESG accounts, and for investors, this research aims to help investors identify whether a company is a "true ESG company."

2. The Relationship Between ESG and Financial Performance

In Li Yuhong's research, it was pointed out that the sustainable development of enterprises, the enhancement of social responsibility and the reduction of operating risks should not and cannot be pinned on enterprises that "do not" implement ESG [5]. Therefore, investors should not refuse to invest in such enterprises because of poor ESG performance. Instead, it is worthwhile to conduct in-depth research and analysis on those enterprises that perform poorly but still have room for recovery and their business models. There are different views in the academic community on the relationship between ESG performance and financial performance. Some studies have pointed out that ESG has a positive impact on many aspects of corporate financial performance [6]. For example, in the field of corporate innovation, ESG practices provide technical resources and information support for innovation activities by increasing R&D investment, while attracting outstanding talent. These factors work together to enhance the competitiveness of enterprises and thus promote the improvement of operating performance [3]. In the field of financing, regular disclosure of ESG information by enterprises can not only reduce the search costs of financial institutions and improve financing efficiency, but also improve investment efficiency by reducing agency costs. In addition, excellent ESG performance can also win the trust of stakeholders, thereby alleviating financing constraints [4]. In terms of corporate reputation, fulfilling ESG responsibilities can help companies accumulate moral and reputational capital and mitigate potential losses from negative events [7]. At the same time, good ESG practices can help enhance brand image and market recognition by alleviating information asymmetry and sending positive signals to the outside world [8]. Finally, in terms of risk management, improving ESG performance can reduce the risks faced by companies and enhance their risk management capabilities [9]. As ESG levels continue to improve, companies are expected to achieve comprehensive risk control and ultimately drive the growth of corporate value [4]. The orientation to rational investors in order to adopt a long-term focus on responsible investing should be a priority for all rational investors, both to fulfill their fiduciary obligations and to align their interests more closely with the broader objectives of societal welfare. This endeavor necessitates a thorough and sophisticated integration of ESG criteria into investment processes to fully unlock the value-enhancing potential of ESG factors. Future research should concentrate on deepening our understanding of the interplay among various ESG criteria in portfolio construction and the specific relevance of individual ESG sub-criteria for corporate financial performance (CFP). Such insights will help illuminate the ESG factors that drive long-term positive financial outcomes,

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thereby advancing the discourse on sustainable investing [10].

2.1 Exploration from the Three Dimensions of E, S, and G

In terms of the environmental dimension (E), manufacturing companies can implement green transformation measures. First, they can use renewable resources. As long as these resources are safe and efficient, transitioning to green is relatively straightforward. Even if there is some resistance, it will generate significant potential benefits. Second, they can optimize resource-efficient supply chains, and the transportation used in this process is crucial. These two aspects not only help manufacturing companies strengthen their relationship with the environment, but also make compliance a convenient legal and ethical dual track. Compliance is not a superficial pursuit to avoid fines, but rather a way to enhance social reputation and market recognition, thereby achieving predictable profitability.

In terms of the social dimension (S), manufacturing companies' actions to fulfill their social responsibilities, such as improving employee compensation and working environment, can enhance employee loyalty and productivity. Furthermore, by strengthening their sense of social responsibility, companies can attract talented talent and partners, creating a virtuous cycle that drives sustained revenue growth. Furthermore, by participating in community development and supporting local education, healthcare, and public welfare initiatives, companies can not only earn the trust and support of the community but also further enhance their product premiums and market competitiveness. In terms of the governance dimension (G), it is specifically manifested in reducing financial losses caused by supply chain disruptions or decision-making errors by strengthening risk control mechanisms. Efforts in this regard will not ignore the goal of attracting sustainable development investors. The efforts of enterprises in this governance dimension have also invisibly promoted the optimization of capital structure and the improvement of long-term financial performance. The "manufacturing enterprises" mentioned here refer to those listed on domestic and foreign securities markets.

2.2 Analysis at the Level of High Pollution and High Energy Consumption

As a high-pollution, high-energy-consuming and high-risk industry, the ESG performance of petrochemical enterprises is particularly closely related to their financial performance. Excellent ESG practices can create financial benefits for petrochemical enterprises in the three dimensions of environment, society and corporate governance, and help them achieve sustainable development. In terms of environmental protection (E), by actively disclosing environmental information and implementing clean production technologies, energy-saving and emission reduction measures, and waste resource utilization, petrochemical enterprises can not only reduce pollutant emissions and reduce environmental governance costs, but also optimize resource utilization efficiency, thereby enhancing market competitiveness. From the perspective of cost-benefit theory, these environmental practices have significantly improved the financial performance of enterprises and won external trust and support by sending positive signals [11]. In terms of social responsibility (S), petrochemical companies can effectively improve employee satisfaction and loyalty by providing fair remuneration, a good working environment and career development opportunities, thereby reducing staff turnover and improving overall production efficiency. In addition, companies actively participate in community construction and support public welfare projects such as education, medical care and poverty alleviation, which can effectively enhance their reputation in the local community, gain community support and reduce potential social risks [12]. These social responsibility practices not only help companies establish a positive image among the public, but also strengthen their relationship with consumers, improve product premiums and market competitiveness. In terms of corporate governance (G), petrochemical companies improve their governance level and achieve sustainable development by reducing agency costs, improving risk control mechanisms and enhancing investor confidence. Establishing a transparent and efficient governance structure and a sound information disclosure system can not only effectively reduce the opportunistic behavior of management and reduce agency costs, but also optimize resource allocation efficiency and ensure the healthy development of corporate operations [4]. In addition, green innovation plays an important role in improving corporate financial performance. According to resource-based theory, a company's competitive advantage comes from its unique resources and capabilities. The implementation of green innovation strategies by petrochemical enterprises can not only transform green advantages into economic benefits, but also accumulate green knowledge and innovation resources, thus enhancing the core competitiveness of enterprises [13]. Based on the cost-benefit theory, green innovation can, on the one hand, improve resource utilization efficiency, optimize production processes, reduce raw material and energy consumption, and thus reduce manufacturing costs [14]. On the other hand, through green transformation, enterprises can effectively avoid social protests or legal liabilities caused by environmental pollution, thereby ensuring their long-term sustainable development.

3. Limitations of Traditional Investment Evaluation Models

In terms of investment evaluation, the discounted cash flow method (DCF) is currently the most commonly used basic method, including the net present value method (NPV) and the internal rate of return method (IRR). In addition, it is supplemented by auxiliary tools such as the payback period method and the accounting rate of return method. The DCF method evaluates the financial feasibility of investment projects by considering the value of time. The net present value method calculates the sum of the discounted present value of the net cash flow of each year during the life of the project at a specified discount rate. Only when the net present value (NPV) is not less than zero is the project considered acceptable. The internal rate of return method measures the potential profitability of a project by calculating the discount rate when the cash inflow is equal to the cash outflow value. Its evaluation criteria require that the internal rate of return is higher than the actual cost of capital. However, these traditional evaluation methods have significant limitations when facing non-financial factors. For example, the DCF method does not fully consider the efficiency loss that may be caused by environmental or social problems during the implementation of the project, while the payback period method and the accounting rate of return method are more inclined to short-term benefits and ignore the consideration of the long-term value of the project. In the context of a low-carbon economy, if companies can incorporate environmental factors into the investment decision-making framework, they will be more forward-looking and competitive. With the popularization of the low-carbon concept, the impact of environmental factors on project investment has received increasing attention. Environmental factors refer to the interactive impact of corporate activities, products, or services on the natural environment. In investment decisions, environmental factors may bring potential benefits to the company or may cause potential costs. Although traditional financial evaluation methods can better measure the direct benefits of investment projects, the potential costs caused by environmental factors still need to be paid attention to. Incorporating environmental costs into the investment evaluation system can help companies more comprehensively measure the long-term feasibility of projects and seize business opportunities and meet challenges in the low-carbon era [15].

4. The Financial Impact of Incorporating ESG Performance Indicators into Capital Investment and Employment

4.1 The Optimizing Effect of ESG Practices on Asset Efficiency

A People's Daily Online report states that in 2013, Risheng Hi-Tech was determined to address the "three wastes" problem. The three wastes (wastewater, waste gas, and waste residue) are treated, and the separated waste salt can be used in chlor-alkali production. The sodium chloride recovery rate exceeds 98%, and the soda ash recovery rate exceeds 90%, significantly improving resource utilization. The company is expected to generate 741 million yuan in revenue. Risheng Hi-Tech has not only successfully achieved effective treatment of the "three wastes" but has also achieved significant economic benefits, demonstrating the strong vitality and economic potential of green transformation. The investment has now fully recovered.

4.2 ESG Performance and Employee Relations

The findings underscore that employees ' perceptions of ESG (Environmental, Social, and Governance) practices significantly enhance retention rates by fostering heightened levels of job satisfaction and organizational pride. Furthermore, employees' pro-environmental behaviors serve to amplify the positive linkage between ESG perceptions and employee retention [16]. The employee turnover rate can be lowered not only through investments in social responsibility initiatives but also by effectively communicating these efforts to stakeholders. Moreover, due to the unique organizational structure of service-oriented companies, such firms should adopt more advanced human resource management strategies and provide supplementary employee benefits. At the same time, these efforts should align with financial performance goals, as higher profitability appears paradoxically associated with increased employee turnover. Lastly, governments can play a pivotal role in mitigating turnover by promoting greater ESG transparency through enhanced ESG reporting regulations and the establishment of a more robust legal framework [17]. Enhancing a firm's ESG responsibility performance contributes to a reduction in litigation risk. Notably, internal control mechanisms act as a mediating factor in the relationship between ESG responsibility and litigation risk. By improving ESG performance, firms can strengthen their internal control processes, thereby mitigating potential legal risks [18].

4.3 ESG and Consumer Relationship

Interestingly, the strength of this positive relationship is even more pronounced among consumers who perceive the focal company to possess a strong reputation, view a high degree of congruence between the company and the cause it supports, and feel a personal connection to the cause championed by the company's Corporate Social Responsibility (CSR) initiatives [19]. Research has found that younger consumers are more inclined to support companies that are environmentally friendly and socially responsible, and are willing to pay a premium for sustainable products. Good ESG practices not only enhance brand loyalty and mitigate the impact of negative events, but also help companies tap into niche secondary markets.

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5. Conclusion

This study found that ESG performance can reduce financing costs and optimize investment returns. While environmental performance (E) has the greatest impact on reducing capital costs in the manufacturing industry, governance performance (G) is even more critical in the financial sector. Furthermore, ESG can reduce labor costs, improve employee retention, attract talent, enhance brand value, and reduce labor disputes in hiring decisions.

Looking forward to future research: First, financial organizations should identify hot topics in ESG and focus resources on deep innovation. For example, emerging areas such as climate finance, biodiversity finance, and impact investing hold immense potential. Financial institutions can leverage these opportunities to further develop and refine their financial "packages" in these areas, truly serving the diverse needs of investors and aligning with overall ESG goals. Second, ESG investment strategies and methods need to be optimized. Internationally, considerable experience and lessons have been accumulated in this area, which Chinese financial institutions can draw on. While some of these lessons offer positive insights, others offer negative examples, potentially correcting their ESG investment biases and improving their overall ESG investment efficiency. Third, ESG investing should be expanded, particularly in fixed income and alternative investments. Applying ESG principles to investment target screening, due diligence, asset valuation, and especially portfolio management can not only enhance the likelihood of scientific asset allocation but also improve the robustness and profitability of these investments. Finally, cultivating professional environmental, social, and corporate governance (ESG) talent is crucial. Through systematic talent development and the development of an industry ecosystem, a solid foundation can be laid for innovative development in the ESG field. Laying a solid foundation for innovative development in ESG.

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