Environmental Social Governance Disclosure and Firm Value: How Does ESG Disclosure Impact Firm Value?

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Abstract. This article offers a comprehensive overview of scholarly literature that delves into the impact of firm value and the disclosure of Environmental, Social, and Governance (ESG) factors in various research studies. The study reveals that there are diverse viewpoints on whether ESG disclosure influences firm value, and it highlights ongoing discrepancies in research findings in this regard. While some companies possess strong ESG disclosures leading to higher firm values, there are also instances where the opposite holds true. This divergence in outcomes can be attributed to several influencing factors, including limited understanding of ESG, variations in ESG disclosure quality among companies, industry-specific characteristics, resource constraints, differences in the weighting of ESG scores, and the substantial costs associated with ESG implementation. Future research is expected to expand its scope in order to provide a more precise understanding of the relationship between firm value and ESG disclosure.

Keywords: ESG Disclosure, ESG Score**,** and Firm Value.

1 Introduction

Sustainable development is considered an important aspect of a country's economic development. This statement is characterized by the impact of the company's operational processes on environmental degradation, social criticism from the community, and governance issues related to its resolution. All these things have attracted significant attention from investors when evaluating a company. Along with the development of the business landscape, investors' assessment of companies does not only focus on financial performance but also involves non-financial aspects. This paradigm emerges from the acknowledgment that relying solely on profit-related data is insufficient for guiding investors' decision-making [1].

One of the company's non-financial performance indicators is Environmental Social Governance (ESG), which has progressively transformed into a crucial metric for assessing sustainable development and corporate social responsibility capabilities [2]. Stakeholders and companies from different countries have shown increasing interest in ESG issues, this is because ESG can contribute to the formulation of sustainable business strategies in shaping the future of corporate growth [3]. Companies can effectively and responsibly demonstrate their commitment to

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ESG by consistently preparing and publishing annual Sustainability Reports. As stated by [4], the achievement of a sustainable business model depends on the company's ability to uphold the triple bottom line, which includes economic factors (profit), social considerations (people), and environmental elements (planet). This strategy is also strengthened by implementing good and effective governance by a company [5].

The surge in academic and business research attention toward ESG disclosure issues in recent years is closely linked to the heightened global investor concern regarding environmental and other non-financial risks [6]. ESG represents Environmental, Social, and Governance in creating a profitable sustainability concept by encouraging companies to be directly involved in environmentally friendly practices [7]. However, in practice, the implementation of ESG has yet to be fully implemented by companies in various countries because ESG disclosure is still voluntary. Mandatory rules have a far more tangible impact on developing countries than voluntary [8].

As companies begin to recognize the importance of non-financial information disclosure, these voluntary disclosures are gradually becoming key inputs to ESG rankings based on disclosure scores used to measure the extent to which companies disclose their non-financial information. Through this ESG score, the company will reflect its performance and effectiveness according to the information published to the public [9]. For obtaining a high score, companies will be obtained if they provide more ESG disclosures [10]–[13].

According to information sources from the 2019 worldwide survey conducted by McKinsey on ESG programs [14], implementing ESG activities can have a high-value impact on the company and its shareholders. Most executives and investment experts agree that ESG is a benchmark for companies to implement their investment strategies, thus leading to increased shareholder value [15]. Research on firm value and ESG disclosure has been conducted worldwide with mixed results and discussions. There are several researchers, such as [3], [16], [17], stating that ESG disclosure can increase firm value. However, the views of other researchers [18]–[20] found that reporting ESG disclosures does not significantly impact firm value. The impact of ESG disclosure on a firm's value is significant when it is geared towards boosting profitability through increased sales. Based on the existence of this phenomenon and the discovery of different points of view from each researcher causing the emergence of inequality in this study. This article aims to explore and directly summarize research related to firm value and ESG disclosure.

2 Literature Review

Research studies on firm value and ESG disclosure have been conducted in different countries with different outcome findings, both justifying and contradictory. This research topic is supported by three main theories used by previous research: signal theory, legitimacy theory, and stakeholder theory.

2.1 Signal Theory

This theory explains how a company communicates information that serves as signals, conveying its condition in a manner advantageous to investors [21]. Cues or signals are a form of assessment by external parties in viewing the company's prospects through financial or non-financial data conveyed by the management in financial reports [22]. This signal theory focuses on reducing information asymmetry between internal and external parties of the company [23]. Therefore, companies can increase firm value on rising stock prices by minimizing information asymmetry and reducing uncertainty to stakeholders through ESG information [24]. Revealing non-financial information related to environmental, social, and corporate governance can be a positive signal that the company is not only interested in optimizing profits but also contributing to the prosperity of society, thus leading to favorable perceptions among investors, creating high profitability, higher value for company assets, and impacting on better market value acquisition [25].

2.2 Legitimacy Theory

Legitimacy relates to the notion that companies are under increasing pressure to show respect for the community and the surrounding environment [26]. Legitimacy theory is defined as a social contract that companies must comply with when carrying out production activities against the values and norms of society [27]. This assertion is also reinforced by [28] mentioning that the survival of the company depends on the recognition it gets from society because of its alignment with prevailing social values. Companies must effectively communicate with diverse parties to obtain legitimacy [29]. The availability of information regarding ESG disclosures has positively impacted companies, allowing them to gain legitimacy quickly. Especially true through demonstrations of corporate social responsibility reflected in the attention given to environmental and societal issues. This way, the company can generate legitimacy and achieve harmony in its operations [30]. A further view expressed by [31] indicates that ESG disclosures can portray a company's dedication to community well-being, ultimately result in sustainable benefits.

2.3 Stakeholder Theory

Stakeholder theory conceptually illustrates that companies must manage all their operational activities by considering the interests of all parties involved [32]. This statement is reinforced by the view of [33], which interprets stakeholder theory as an effort to extend corporate responsibility to all stakeholders, not only to shareholders but the company must be responsible for maximizing profits for other stakeholders. To secure backing and confidence from stakeholders, the company must provide information that reports all business activities carried out to maintain and sustain the sustainability of the company. Companies can obtain this support by disclosing ESG information that can provide sustainable benefits [34]. Thus, the company will be recognized by stakeholders and known to the public if it has fulfilled social obligations, cares for the environment, and pays attention to good corporate governance performance [35].

2.4 Firm Value

Definition of firm value is the price potential buyers are willing to propose when a company is up for sale [36]. High company value is one indication of the business's success. According to the opinion expressed by [37], one way to find out a firm's value is to look at its stock price because stock prices can represent the actual value of a company's assets at a high rate of return on investment [38]. Therefore, the firm's value will always be a consideration for investors in making investment decisions [39].

2.5 ESG Disclosure

ESG disclosure is defined as the measure a company uses in formulating reports on environmental, social, and governance practices [40]. Comprehending ESG diclosure serves as a crucial metric for gauging and appraising a company's effectiveness in executing its activities. Companies must adhere to the principles of corporate governance as per regulations, which aim to foster a good image among stakeholders and society [41]. As a result of these ESG disclosures, companies can increase to enhance the utility of the information to be disclosed to the public.

3 Method

This research article uses the systematic literature review method. The definition of systematic literature review (SLR) is a systematic process aimed at identifying, assessing and interpreting all existing evidence findings [42]. In the process of data collection, researchers carry out documentation methods. The necessary supplementary data comprises articles pertinent to the subject matter under investigation. Related literature selected in the study examines the issue of firm value and ESG disclosure. This method identifies, integrates, and evaluates literature, and the results will be interpreted as findings obtained from various previous research sources.

4 Results

Given the importance of ESG in sustainable business, this could influence many studies exploring its impact on other aspects, significantly how this can impact firm value. Several studies discussing firm value and ESG disclosure have been conducted in various countries. The table below contains the titles of research articles selected based on their credibility and publications published within the last five years.

Table 1. Previous Research

No.	Author Name	Year	Research Title
1	Mahmut Aydoğmuş, Güzhan Gülay, and Korkmaz Ergun [6]	2022	"Impact of ESG performance on firm value and profitability"
2	Shiyu Wu, Xinyi Li, Xiaosen Du, and Zexin Li [43]	2022	"The Impact of ESG Performance on Firm Value: The Moderating Role of Ownership Structure"
3	Nermain Al-Issa, Audil Rashid Khaki, Ammar Jreisat, Somar Al-Mohamad, Dina Fahl, and Emira Limani [25]	2022	"Impact of environmental, social, governance, and corporate social responsibility factors on firm's marketing expenses and firm value: A panel study of US companies"
4	Daniela Constantinescu, Chirața Caraiani, Camelia I. Lungu, and Pompei Mititean [44]	2021	"Environmental, social and governance disclosure associated with the firm value. Evidence from energy industry"
5	Zifeng Feng and Zhonghua Wu [45]	2021	"ESG Disclosure, REIT Debt Financing and Firm Value"
6	Anna Melinda and Ratna Wardhani [9]	2020	"The Effect of Environmental, Social, Governance, and Controversies on Firms' Value: Evidence from Asia"
7	Nor Edi Azhar Binti Mohamad [46]	2020	"Do Environmental, Social, and Governance Practices (ESG) Signify Firm Value? Evidence from FTSE4 Good Bursa Malaysia (F4GBM)"
8	Yen-Yen Y [47]	2019	"The Value Relevance of ESG Disclosure Performance in Influencing The Role of Structured Warrants in Firm Value Creation"
9	Ahmed Aboud and Ahmed Diab [48]	2018	"The Impact of Social, Environmental and Corporate Governance Disclosures on Firm Value: Evidence from Egypt"
10	Yiwei Li, Mengfeng Gong, Xiuye Zhang, and Lenny Koh [49]	2018	"The Impact of Environmental, Social, and Governance Disclosure on Firm Value: The Role of CEO Power"

5 Discussion

One of the driving factors for a lot of research on firm value and ESG disclosure is caused by the point of view of investor considerations in making investment actions against companies, by no longer only relying from financial data as well as other non-financial information that the company itself shares with the public [50]. The first discussion will begin with research on firm value and ESG disclosure. There has been much previous research on this topic. However, the authors only discuss five selected journals based on different phenomena, backgrounds, and implications. The study conducted by [9], [43], [44], [47], [48] states that ESG disclosures made by companies have an impact on firm value and can influence how the investor makes investment decisions.

A study was conducted [43] to examine closely the impact between ESG performance and a firm's value. This research encompassed a survey of 1.379 manufacturing sector firms in China from 2016 to 2020. The results of this inquiry show that the evaluation of ESG (Environmental, Social, and Governance) performance through the Sino-Securities Index Information Service Co., Ltd. in Shanghai, China, can positively impact a firm's value. Moreover, two other variables, namely executive and institutional ownership, exhibit a positive and statistically significant influence on the firm's value. Conversely, ownership concentration and equity distribution have impact on the firm value overall worth. According to the survey findings, proficient management of ESG performance can contribute to alleviating funding constraints, enhancing operational efficiency, and mitigating financial risks, thereby fostering an increase in firm value. ESG performance metrics serve as indicators of environmental preservation, social accountability, and corporate governance status, offering a holistic perspective on corporate responsibility and future growth potential.

The correlation between environmental social governance (ESG) factor disclosure and a firm's value has been investigated in a study conducted by [44]. This research utilized a dataset of 266 observational samples drawn from companies operating within the energy sector, classified according to Thomson Reuters. Spanning four years (2015-2018), the research uncovered a clear link between the disclosure of ESG factors and the valuation of companies in the energy sector. This relationship was evident in individual and combined testing, revealing a statistically significant positive association between ESG disclosure factors and firm value. The findings were substantiated through two regression models assessing market value and Tobin's Q. This constructive correlation may incentivize corporate executives to embrace ESG disclosure policies, emphasizing aspects related to environmental considerations, human resources, and overall company management. This strategic approach aims to attract investors and secure fresh capital, enhancing the firm's overall value.

Previous research that states ESG disclosure impact firm value has been supported by research [9]. The findings revealed that ESG index scores, encompassing Environmental (ENV), Social (SOC), and Corporate Governance (GOV) dimensions, exhibit the capacity to impact a firm's value as measured by Tobin's Q. Similarly, ESG controversy scores exhibit a statistically significant relationship with firm value. The research, spanning 2014 to 2018 and involving a survey of 1.356 companies across 22 Asian countries, underscores that controversies communicate positive signals to investors regarding a company's dedication to openness and responsibility. The study indicates that companies reporting robust environmental, social, and governance performance tend to have higher firm value than those neglecting such reporting. Furthermore, the study concludes that companies should consider their ESG performance actively, as favorable performance corresponds to increased firm value. In contrast, bad ESG performance can lead to a reduction in firm value.

Studies examining the potential impact of ESG disclosures on a firm's value have been carried out by [47]. This research utilized a dataset comprising 37 Malaysian companies and 795 structured warrants associated with publicly listed Malaysian firms, spanning 2012 to 2017. The findings indicate a positive correlation between ESG disclosure scores and firm value. The study's conclusions highlight that elevating stakeholder trust and enhancing transparency and accountability can create firm value. Consequently, the ESG disclosures made by companies serve as valuable tools for augmenting firm value while also aiding in reducing information asymmetry among investors, promoting transparency, and enhancing investor capacity for processing information in investment decision-making.

Research on how disclosure of environmental, social, and corporate governance information impacts firm value has also been conducted [48]. This research adopted a quantitative approach, focusing on 100 companies listed on the S&P / EGX ESG Index (Egyptian Corporate Responsibility Index) from 2007 to 2016. The study's outcomes unveiled a positive impact between a company's ranking in the ESG index and its firm value as gauged by Tobin's Q. Companies listed on the index that actively engage in ESG practices demonstrated higher firm values than non-listed counterparts. Moreover, index-listed companies were better poised to gain recognition from stock market authorities, providing them with a competitive edge and contributing to increasing their firm value. ESG indices also enable investors to take a significant part in motivating companies to improve their openness and release reports on non-financial information. These findings underscore the advantages of ESG and highlight the significance of implementing robust policies for governing corporate sustainability practices.

The following discussion related to the results of research conducted by researchers such as [18], [51]–[54] showed that there was no influence between firm value and ESG (Environmental, Social, and Governance) disclosure. This result happens because ESG disclosure metrics have not played an essential role for companies in reporting and disclosing information related to non-financial aspects that are sustainable. Research investigating the impact of ESG disclosure on firm value has been conducted by [52]. This research centered on the investigation of 1.372 Chinese firms listed on the Shanghai and Shenzhen A-share markets, with available ESG rating information covering the period from 2015 to 2019. The findings of the study indicated that the disclosure of ESG-related information, as gauged by SynTao Green Finance's ESG ratings, did not significantly impact the firms' value. Disclosing information related to the environmental, social, and governance aspects comes with various requirements that can lead to substantial cost burdens for companies implementing ESG practices. It resulted in a notable negative correlation between the ESG ratings and the performance of these companies. The study found that engaging in ESG investments would only lead to additional costs for the organizations. The research also concluded that the varying levels of comprehension and application of ESG principles might be attributed to the developmental disparities between emerging and developed markets. In contrast to established developed nations, many emerging market economies are still in their early stages of economic growth and require more resources, resulting in a limited grasp of ESG concepts. These emerging market economies often prioritize economic expansion in terms of scale, speed, and related financial indicators, potentially leading them to disregard ESG concerns. Furthermore, stakeholders in advanced economies, including shareholders, creditors, and regulatory authorities, generally place a greater emphasis on corporate social responsibility information compared to their counterparts in emerging economies.

In a subsequent study carried out by [53] which involved a selection of Korean companies that were listed on the stock market during the period spanning from 2011 to 2017. His research findings stated that none of the ESG Disclosures had a statistically significant relationship with firm value. ESG disclosure using Bloomberg score weighting could not provide positive results on firm value. The research review also concluded that aggregate ESG disclosure scores mean little, so market participants do not consider non-financial ESG information as important as financial information.

The influence of ESG disclosure on firm value has also been explored by [54]. This research utilized data according to the findings of the study, involving 310 companies listed on the Indonesia Stock Exchange from 2017 to 2021, revealing that ESG disclosure, as gauged by the combined ESG score, did not impact firm value. This observation research also shows that Indonesia is classified as a developing country where many companies have yet to embrace the concept of sustainability or make public disclosures concerning non-financial aspects. Additionally, implementing ESG practices in Indonesia is still in a progressive phase. Consequently, shareholders tend to believe channeling investments into ESG initiatives could result in costs that outweigh the benefits of optimizing the firm's value.

Research conducted by [51], employed a quantitative methodology to analyze 38 global airlines spanning 2009 to 2019. The research outcomes indicated that not all aspects of ESG disclosure, evaluated using Thomson Reuters Eikon database indicators, can impact firm value. Specifically, only the governance dimension impacts the firm's value, whereas the social and environmental dimensions demonstrated no significant impact and were negatively correlated. The findings suggested that a firm's endeavors to engage in ESG disclosure practices aimed at shaping a positive image among stakeholders and the public, mainly through environmentally conscious initiatives such as adopting reusable resources, fostering innovations, and reducing carbon emissions, could lead to reductions in market ratios and potentially pave the way to financial difficulties.

Further research was conducted by [18] investigated how ESG reporting influences a firm's value-related performance and the moderating impact of a firm's competitive advantage on the connection between ESG reporting and performance based on value. The study analyzed secondary data from the annual reports of 20 manufacturing companies in Nigeria spanning from 2017 to 2021. The findings of the study indicate that ESG reporting has no significant direct impact on a firm's value, but its influence becomes significant when moderated by a company's advantages. The effect of ESG disclosures on a firm's value depends solely on their strategic alignment to boost profitability through increased sales.

6 Conclusion

This article aims to explore, blend, and elaborate on the growing literature on ESG disclosure and firm value. The findings of this study are to give conclusions based on previous research and see how relevant the research is to the conversation of current topics. Revealing ESG disclosure is crucial for enhancing a company's worth and demonstrating commitment to environmental preservation, social accountability, and governance effectiveness, all contributing to corporate resilience and sustainability. Sectors in which companies demonstrate good ESG practices have a reasonable likelihood of garnering acknowledgment from governmental agencies. This recognition, in turn, contributes to establishing trust among stakeholders and the wider public

Based on extensive research conducted by previous researchers, the impact of ESG disclosure on firm value has concluded inconsistent results and is still debated. Some experts have found that ESG disclosure positively correlates with increasing firm value. Another group of researchers found the opposite impact. The various concluding arguments of each of these researchers can be caused by things such as differences in the level of ESG understanding between developing and developed countries, ESG disclosure capabilities possessed by each company, the nature of environmentally sensitive industries and environmentally insensitive industries, insufficient resources, differences in the weighting of each firm's ESG scores, and the high costs that must be incurred when implementing ESG practices.

This research has not undergone an extensive and in-depth examination, nor has it significantly contributed to the understanding of firm value and ESG disclosure across multiple global regions. In future research, it is anticipated to conduct a more comprehensive literature review, encompassing a larger number of previous studies and articles from various geographical areas. Furthermore, it should involve comparing research findings related to the connection between firm value and ESG disclosure within each of these regions.

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