



Nexus between Environmental, Social and Governance (ESG) Pillars and Financial Performance of Pakistani's Firms

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Abstract: Concentrating on ESG issues has become a point of interest for shareholders, investors and governments, like a risk management concern. The primary objective of this research study is to determine the impact of ESG on financial performance. The current study contributes to the existing body of literature in the following distinctive manners. Firstly, the current study examines the influence of ESG on the financial performance of firms. Secondly, the study uses country-level governance as a replacement form of firm-level. The present study analyzes the available sample from non-financial sector, listed on the Stock Exchange of Pakistan from 2013-2022. The present study calculates the dependent variable from accounting-based approach which is Return on assets (ROA). This study applied ordinary least square regression (OLS) to analyze the panel data. The result of the study depicts that environmental, social and governance are significant determinants that influence the financial performance in Pakistan. The results of this study provide a guideline for policy management and practical implication to non-financial firms, shareholders and policymakers.

Keywords: ESG; financial performance; ROA; OLS; Pakistan

1. Introduction

According to neo-classical economics and a number of management theories, a company's main goal should be to maximize profits (Galbreath, 2013; Jamal et al., 2022). Zingales (2000) asserts that shareholders play a major role in profit maximization as they are the primary source of the required capital for the operations of the company (Zingales, 2000; Jensen & Meckling, 1976). However, there are significant differences in how businesses see and act upon profit maximization in this cutthroat environment. Various firms employ distinct tactics. For example, some businesses prioritize long-term success above short-term results (Brochet et al., 2011). The effects of an organization's operations on other stakeholders and the environment are prioritized by some organizations, while several organizations pay less attention; in addition, some organizations consider ethical issues in their decision-making process (Paine, 2004). The global financial crisis has stunned the markets globally, initiating an economic crisis and social consequences which demanding remarkable levels of government intervention (Nicholson et al. 2011). The global financial crises have elevated the firm's interest in accountability, ethical behavior, good supervision, and their capability to strategically manage an extensive group of stakeholders. In spite of this the global crises also heightened that the world is quickly shifting. Economies are inevitably inter-connected. Politics and globalization are merging to create a significant change in urbanization, populations, climate change, resource

utilization, and employee and consumer attitudes. The NGOs played a vital role in corporate accountability. Companies currently operate in a more transparent environment than ever simply because of their role, (OECD 2004). Significantly, the global financial crises have focused the attention of firms to deal the shareholders and stakeholders in a similar way. This is the leading growth attitude in the assimilation of ESG factors by institutional as well as individual investors, (Mañescu 2011; Boerner 2010).

ESG has played a central role in socially responsible investors, (SRI) for a long time period. Socially responsible investors are a group of investor that uses ESG information in addition to traditional financial criteria in their investment strategies. According to Louche (2004) in 1990s, the SRI shifted from a moral activist movement to a profit-making venture and many traditional banks and investment houses began developing socially accountable resources to fulfill the increasing demand for SRI in the marketplace. Within the economic community, however, these advances stayed trivial and ESG separated from traditional investment operations. But a fresh trend is starting over the last century. The economic analysts and fund managers are gaining interest in ESG variables. Indeed, a growing number of analysts declare that they are committed to incorporating ESG information into their investment procedures. This is demonstrated that a large number of financial communities trying to consider the non-financial dimension of ESG, (Sofres, 2003; Ambachtsheer, 2005; Pleon, 2005). The raising awareness by the majority of investment community in ESG is motivated and persistent by a number of individual and institutional initiatives.

ESG is well-known perception in develop countries however in the context of developing economies this phenomenon commenced recently (Ahmad et al., 2021; Garcia et al., 2017). The implementation of ESG remains a challenge in developing countries (Tilt et al, 2021; Zahid Ghazali, 2015; Zahid et al, 2019). The basic reason behind this fact is that investors in developing countries are just interested in wealth maximization. So the investors did not consider non-financial issues like ESG. From the emerging countries' perspective, organizations are more probable to concentrate on capital accumulation but unaware to distinguish the potential and long-term benefits of ESG investment (Garcia et al., 2017).

But now the approach is changing, firms are responsible to report information to all stakeholders not only to shareholders. Because communities are not only affected by the corporate operation but also the natural environment is suffered in which firms operate. The SECP (Security and Exchange Commission of Pakistan) in 2009 passed the code that all companies must consider sustainability issues and encouraged that companies which follow these dimensions. But there is a problem if firms in emerging countries follow the sustainability dimension (ESG) will it be profitable for them or not? This is also unexplored by researchers which level the determinant of ESG brings high financial benefits for firms?

The present study aims to highlight the issue related to ESG in the following distinctive viewpoints. First of all this study investigates that is there any significant association between ESG and financial performance. Secondly, this study is an exclusive influence in the literature because the researcher studies which level the determinants of ESG best explain financial performance. Financial performance is widely measured by an accounting-based method such as return on assets (ROA) (Yu et al., 2018; Pintae et al., 2014; Ortas et al., 2015). Lastly, according to the finest of the researcher proficiency all of the studies on ESG used firm-level variables such as vision and strategy, board structure, compensation policy, etc for calculating governance factors, (Sahut & Pasquini-Descomps, 2015; Miralles-Quiros et al., 2018; Xie et al. 2019). But the current study practices Kaufman et al. (2011) country-level indicators like political instability, rule of law, corruption control, voice and accountability, governance effectiveness as well as regulatory quality for calculating governance factors. The paper is organized as follows. First, a literature review consist on definition of ESG, theories and previous work on ESG, Second, the, results and discussion are presented. Lastly, the implications of the findings and future research directions are discussed.

2. Literature Review

2.1 Definition of ESG

Environmental Social Governance (ESG) can be acknowledged as a set of processes or activities that associate the relationship of organizations with ecological surroundings, its co-occurrence and interaction with all living organisms, including humans, animals, and plants, as well as a corporate system of central controls and procedures (i.e. customs, processes, laws, policies, rules and regulations) to direct and administer the organization issues for the purpose to consider the interests of all the stakeholders, (Jamal, et al, 2022; Whitelock, 2015). ESG integrated into a firm's strategic planning can be a differentiator, particularly for those who evaluate and associate ESG factors with a firm's future projections. Such firms may possibly create a competitive advantage, particularly if others are unable to see the same dangers or opportunities associated with such characteristics, (CFA, 2008). In this

regard, a stakeholder strategy that includes active engagement with a firm's management and its Board of Directors on ESG activities, practices and processes can potentially lower risk and enhance enduring value creation. Such an approach leads to a strategic orientation that enables differentiation and improved ESG performance.

2.2 Theories behind ESG

Many theories have been created to explain the contribution of business organizations in the development of economy and building of societies. These theories specify the roles of shareholders, employees, lenders/creditors, buyers/sellers/suppliers, current governments, and people. The main purpose of these theories are to find out the various extents of organizations performance, interactions, the possible outcomes and restrictions which can influence the foremost business consequence to create shareholder value. These theories are described in the succeeding sections.

2.2.1 Shareholder Theory

Jensen and Meckling (1976) presented the shareholder theory. The core essential of this theory revolves around the fundamentals that highlight that the personal interests of business owners and executives are often different. The wealth maximization theory also explains that the real owners of a firm are its shareholders. The managers are responsible for maximizing the wealth of the real owners of the firm (Shleifer & Vishny 1997). This theory focuses on narrow aspect of business sustainability.

2.2.2 Stakeholder Theory

Stakeholder theory was developed by Freeman (1984), and Jensen's (2001) as value or wealth maximization theory. According to this theory the long-term value are the core essentials for balancing the interests of every stakeholder. Non-financial ESG sustainability efforts establish synergies in the context of stakeholder welfare maximization and shareholder wealth maximization. According to stakeholder theory, sustainability actions and performance contribute to the company's value-gaining mission. This theory is related to all the factor of ESG.

2.2.3 Institutional Theory

According to Institutional theory the firm is consider a broad group or institution of stakeholders. The stakeholders have common goal. Strang (1990) sets the institutional theory application to national and international governmental policies. DiMaggio (1991) and Fligstein (1985) use the application of institutional theory for the development of forms and missions of the organization. This theory is related to the governance factor of ESG. Institutional theory explains that any organization in the form of an institution focuses more on the mutual interests and shared benefits as compared to individual benefits and incentives.

2.3 Previous Studies on ESG

Huang (2021) outlined the justification for business ESG endeavors. Notwithstanding the vast and expanding body of literature, this author contends that more research is still needed to understand the connection between ESG measures and financial performance. ESG activities occur inside institutional contexts and are viewed as distinct organizational constraints and individual decision-makers. As a result, there is a need for a theory that accounts for both the internal and external drivers of ESG initiatives.

In the other literature review, Cunha et al. (2021) claim that the sustainable finance literature is overly fragmented, making it difficult to define its scope and, more importantly, distinguish it from traditional finance. Despite significant scholarly output, the authors recognize that many problems remain unsolved and require further research. Mohammad and Wasiuzzaman (2021), have researched the impact of different ESG factors on a firm's overall performance and growth. They used competitive advantage as a moderator. This study used a sample of the data comprising 3966 firm-year observations and considered the time frame from 2012 to 2017. Precisely, 661 firms are studied. The results highlight that ESG disclosure can improve the firm's growth and performance even after controlling for competitive advantage. Their study also proved that improving ESG disclosure in Malaysian firms by only one unit would enhance their performance by roughly 4%.

Another study conducted by Ahmad et al. (2021), inspected the firms performing in UK the researchers studied the effect of ESG measures on firm's performance. The sample period consists of 2002 to 2018. The researcher investigated both the aggregate and individual aspects of ESG and the financial performance for firms operating in UK. The researchers investigate the panel data through dynamic as well as static approaches. This study also

highlights the impact of different ESG intensities on performance and growth of firms. The firm size is used as a moderator for the purpose to investigate the role and influence of ESG on the performance metrics. The results depict that the entire ESG metric show a progressive and prominent influence on the firm's overall financial performance and growth. But the situation is different for individual ESG performance. However, the outcomes depicts that high ESG firms are more profitable than those with low ESG metrics. The results also identify that firm size moderates the association between ESG metrics and growth as well as the financial performance of the firm.

Sadiq et al. (2020) studied the relationship between ESG and the market performance of firms. The sample was extracted from 122 firms listed on Malaysia's stock exchange. The sample period was from 2011 to 2019. The number of total observations was 1098. The researchers used three independent variables: a profit-sharing arrangement, CSR committee and their decisions, and the company's ownership. The researchers analyzed the data through a correlation matrix, first-stage regression and second-stage regression to find out the effect of ESG on independent variables. Second stage of regression is essential because this model highlights the ESG properties highly related to the market performance. The results depicted that ESG enhances the market performance for Malaysian firms. The outcomes of this study highlighted the ESG importance for firms to enhance their strength and opportunity and alleviate the negative consequences.

Another perspective was presented by Broad stock et al, (2021). They have investigated the impact of ESG during the COVID pandemic. In the COVID situation, the physical and economic lockdowns has distorted the economy. These strange and rare situations allow researchers to investigate the stockholder's consideration in ESG performance to enhance the future stock concert. The consequences of the study depicts that high portfolios of ESG show more effect than low portfolios of ESG. As a result, the inclusive performance diminishes the financial risk during uncertainties. Muslichah (2020) assessed the effect of environmental and social disclosure (ESD) on firm value considering performance as a variable. Many companies participated in the process. The result of this study also clarified that there would be a positive impact of ESD on financial performance and growth. It also explains that the impact of performance on firm's aggregate value will remain positive. The research findings confirm the rule of legitimacy – the theory in which the stakeholders have little to no power to play an active role into firm's social and environmental activities. The outcomes gathered from this study have also benefitted managers. The results clearly explain that ESG is unavoidable for any company looking to legitimize its products in the eyes of buyers and investors. This study was a valuable resource for creating and nurturing socio-environment principles for the general public.

Another researcher who actively researched the concept of ESG was Gerged et al. (2021). Their research examined the connection between corporate environmental disclosure (CED) and value taking into account the countries in the Gulf Cooperation Council (GCC). In these regions, the CED has been showing a rising trend. The researchers took a multicounty sample consisting of 500 observations. They have used a 55-item un-weighted disclosure index. The research outcomes demonstrated the positive relationship between the determinants in question and ROA. However, the relationship wasn't as strong as mentioned in the case of Tobin's Q. This study concluded that both managers and top contributors in government working in GCC countries must take a positive view of CED.

Fakoya and Malatji (2020) observed the role of mutual-fund managers in the context of ESG. The researcher investigated the ESG issues while deciding a specific sector to invest. It is essential for manager when they're making decisions on behalf of their trustees. The study sample consists of top 20 South African mutual fund companies. Panel data analysis approach is used in the study. The results of the study confirmed the negative association between ESG and ROE. It is clear from the results that South African firms did not consider the guidelines of the United Nations Principle of Responsible Investment (UN PRI). Furthermore study indicated that asset managers mainly stress on improving profit maximizations and are deprived of giving attention to ESG factors.

2.4 Hypothesis Development

Organizations can generate sustainable performance when they survive in the long way of profitability. Despite this, financial performance and ESG performance measurements are selected combined because they can complement each other, and at the same time, trade-offs can occur. Effectively governed corporations and responsible toward society as well as environment are liable to generate more performance, create value for the shareholder, acquire trust and confidence from the customer. But the other view, economically solid and practical organizations are at better levels by holding additional means to serve the environment and society. Still the primary objectives of numerous corporations are to boost shareholder value. To deliver more economical

performance, the firms used ESG issues effectively to boost stakeholder value. Yet, the relationship between ESG and financial performance is not that much clear.

Social responsibility and the consideration of intangible assets like a good reputation and human rights boost competitiveness and long-term financial performance as examples of how ESG benefits financial performance. However, the inverse effect is interrelated to the sentiments that ESG factors are expensive and decrease shareholders' value. But the truth is that companies interested in ESG performance will be judged to be more considerate of the environment and social issues and have more advanced corporate governance. Firms that follow ESG guidelines can attract talented employees, so raise the firm productivity. Likewise, enhancements in ESG influence the financial performance and decrease the cost of capital.

2.4.1 Environmental Pillar

Environmental performance can be described as reducing the consumption of hazardous materials, generation of waste, consumption of energy as well material usage, and lastly, following all the environmental protocols, (Jin & Zialani, 2010). It determines the corporation consequence on natural systems, either living or non-living, also includes land, water, and the air (in simple words completes ecosystems). It shows the extent to which a business employs the best management practices to reduce environmental risk and make the most effective use of available environmental possibilities, (Ortas et al., 2015). According to Limkriangkrai et al. (2017), it is the obligation and duty of corporations to reduce the negative impact on the environment and adhere to ecosystem control. For the reason that the environmental factors have severe impact on business financial performance.

Limkriangkrai et al. (2017) explain that the environmental initiative means performing duties associated with minimising waste. The most critical areas to be considered are climatic changes, waste reduction, water usage, pollution reduction, and planting more trees to reduce global warming. A conflicting point of view shows that a well-developed financial system as well as better economic growth of a country fascinates foreign direct investment (FDI). New production techniques are designed to reduce the amount of carbon consumed in the host nations' economies, as well as the presence of more foreign businesses. Eskeland & Harrison (2003), and Kumbaroğlu et al., 2008 also point out the lower CO₂ emissions. The following parameters are used to calculate the environmental determinants of ESG for this research: waste reduction, CO₂ emission, water consumption, energy consumption, and product innovation (Miralles-Quirós et al., 2018; Xie et al., 2018; Ferrero-Ferrero et al., 2016; Duuren et al., 2016). From empirical literature and based on various theories the researcher assume then following relationship for this work.

Hypothesis 1: There is a positive relationship between environmental pillar of ESG and the financial performance of firms.

2.4.2 Social Pillar

Social performance describes the firm's competence to satisfy stakeholder expectations regarding social concerns, and the ultimate goal is to heighten the company's appearance in front of the general public as well as firm's employees (Jin & Zialani, 2020). It is possible to define social as well as organization's capacity to cultivate consumer trust using the finest possible management techniques. The company's reputation is reflected in it, creating long-term value for the organization, (Ortas et al., 2015).

According to Sultana et al. (2018) social performance states shield and protect the rights of people also improving the living standards of the community. These factors included labour standard, gender diversity, community relations, human rights, health and safety and employee commitment (CFA, 2008).

The following elements comprise the social pillar of the ESG: health and safety, human rights, training and development, and community development. (Duuren et al., 2016; Xie et al., 2018; Miralles-Quirós et al., 2018; Ortas et al., 2015; Ferrero-Ferrero et al., 2016). Investment in society may increase and improve the stakeholder's value by rapidly increasing sales, encouraging and empowering employees, increasing productivity growth, and driving innovation. Here, the role of CSR is critical as it can help improve a firm's goodwill and repo, build customer loyalty, and impact customer demand (Lev et al., 2010). Analyzing different theories and empirical work, the researcher assumes a subsequent hypothesis for this study.

Hypothesis 2: There is a positive relationship between social pillar of ESG and the financial performance of firms.

2.4.3 Governance Pillar

The methods through which a society's rules are established, operated, and evolved are called governance. Although the state's formal institutional framework is vital in establishing a society's governance, governance is about much more. Governance is complicated and context-dependent in reality. It requires the interaction between formal and informal processes, rules and relationships. Because of this, governance involves dealing with power and determining who has the authority to establish and enforce social norms. La Porta et al. (1999) describe the components that come from social, political, and cultural perspectives what determine how effective a government is. La Porta also determines that cultural differences, as well as religious and ethnic diversity, affect how the government operates and completes its tasks. But the results of Islam and Montenegro (2002) recommended that social attributes are not related to institutional quality.

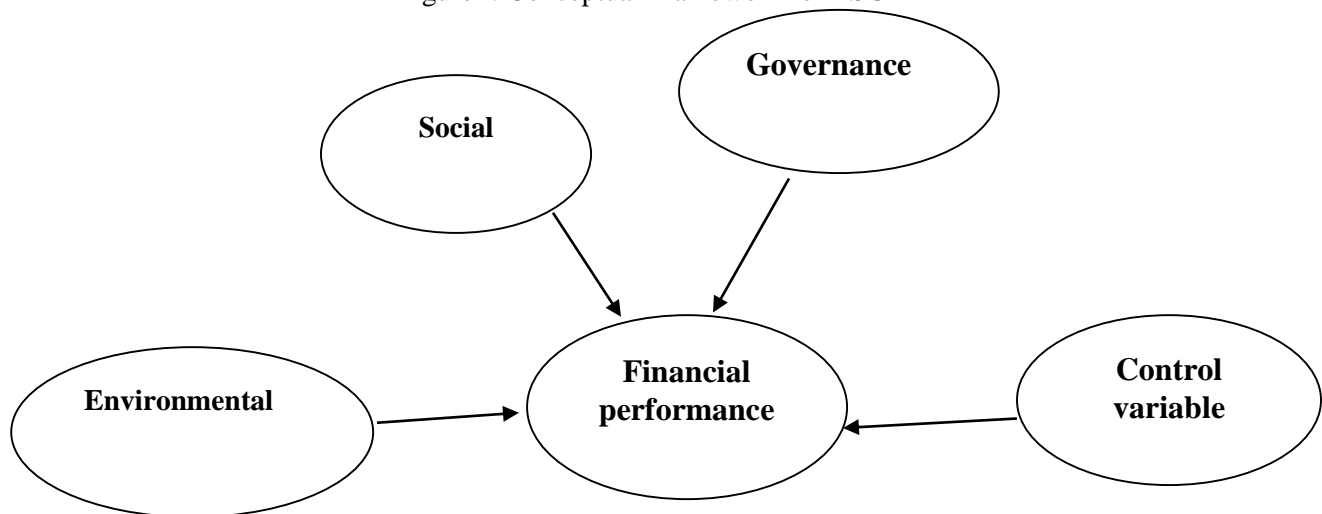
Agreeing with the mention sources (Kaufman et al., 2005; Yu et al. 2018; Petzer et al., 2012; Judge et al., 2008;) the governance pillar of ESG is calculated from these factors, voice and accountability, Political stability and absence of violence, Governance effectiveness, Regulatory quality, Rule of Law, and Control of Corruption. The researcher assumes the following hypothesis for this research study;

Hypothesis 3: There is a positive association between governance pillar of ESG and financial performance.

2.5 Conceptual Frame Work

The objective of this study is to associate financial performance with ESG. ESG is the combination of CSR as well as corporate governance. As a result, the concept of CSR (which cover social and environmental factors) and corporate governance in context of financial performance is explained. This research used ESG as the independent variable. However, the dependent variable of the study is financial performance.

Figure I: Conceptual Framework for ESG



3. Research Methodology

3.1 Sample and Data

This research study was analytical. These researches are based on evidence or information which is already accessible and is used in further analysis to conclude. This research makes use of the Panel data type. Panel data emanated from different companies upon multiple times and periods. The panel data carries both characteristics of cross-sectional and time-series data. The data for this research study was conducted in Pakistan. The sample for this study was the available firms from non-financial firms listed on Pakistan Stock Exchange (PSX). This study used 10 years of data from 2013 to 2022. The data relating to all variables are collected from companies' annual reports, sustainability reports and World Bank.

3.2 Variables

The dependent and independent variables were chosen in the light of various theories and motives of ESG and from the review of the extensive empirical literature.

3.2.1 Dependent Variable

The dependent variable for this research study is financial performance. The researcher in this study used accounting based approach for measuring financial performance. In the accounting-based approach, measurement is based on return on assets (ROA). The return on assets means that the net income received by the firm in comparison to the total assets of the firm. It is calculated by net income divided by total assets, Pintea et al., (2014), Muslichah, (2020).

3.2.2 Independent Variables

The independent variables for this study are environmental, social and governance. The Table.II shows the independent variables, its explanation and seminal studies as evidence that used these variables as proxies. The environmental determinants of ESG for this research are calculated from the following factors: waste reduction, CO2 emission, water consumption, energy consumption, and product innovation (Miralles-Quirós et al.,2018; Xie et al., 2018;Ferrero-Ferrero et al., 2016;Duuren et al.2016). The following elements comprise the social pillar of the ESG: health and safety, human rights, training and development, and community development. (Duuren et al., 2016; Xie et al., 2018; Miralles-Quirós et al., 2018; Ortas et al., 2015; Ferrero-Ferrero et al., 2016). Agreeing with the mention sources (Kaufman et al., 2005; Yu et al. 2018; Petzer et al., 2012; Judge et al., 2008;) the governance pillar of ESG is calculated from these factors, voice and accountability, Political stability and absence of violence, Governance effectiveness, Regulatory quality, Rule of Law, and Control of Corruption.

3.2.3 Control Variable

The researcher has control the effect of some variables in this study. The effect of these variables is normalized with the help of logarithmic transformation, (Lee, 2012; Slater & Romi, 2013). Firms Size is estimated as logarithm of total assets, Mohammad & Wasiuzzaman (2021). Firms Age is assessed as age of the firm since its enlisting on stock exchange, Gandía, (2008). Firms Leverage is assessed by total liabilities over total assets, Gerged, (2020).

4. Data Analysis

4.1 Descriptive Statistic of Pakistan

Descriptive statistic shows the key summary of the data. The descriptive statistic for calculating the ESG impact on financial performance for Pakistan is shown in the Table; I below.

Table: I: Descriptive Summary of Pakistan

Variable	N	Mean	Median	Maximum	Minimum	Std.Dev
ROA	650	11.925	9.97	74.19	-58.42	10.547
ENV	650	1.995	1	5	0	1.879
SOC	650	3.165	4	4	0	1.252
GOV	650	123.411	123.28	136.234	111.891	8.611
SIZE	650	7.015	6.984	10.041	5.253	.714
AGE	650	43.815	40.5	73	13	16.862
LEV	650	.417	0.235	5.985	0	.647

The Table represents the descriptive statistics for financial performance of Pakistan.

4.2 Correlation Matrix

Correlation matrix shows the association between dependent and independent variable. It value range from +1 to -1.

Table 2: Pearson Correlation Matrix for ROA of Pakistan

	ROA	ENV	SOC	GOV	SIZE	AGE	LEV
ROA	1.000						
ENV	0.239	1.000					
SOC	0.249	0.579	1.000				
GOV	-0.019	0.130	0.065	1.000			
SIZE	0.058	0.317	0.330	0.098	1.000		

AGE	0.043	0.241	0.041	0.000	-0.025	1.000
LEV	-0.057	-0.121	-0.099	0.003	0.040	-0.151
						1.000

The Table displays the Pearson correlation matrix among variables with their significance levels. ***, ** and * represents values statistically significant at 1%, 5% and 10% respectively.

4.3 Ordinary Least Square (OLS) to explain Financial Performance

The ordinary least square model (OLS) or linear least square model is a statistical technique used to determine unknown parameters in a linear regression model, with the goal of minimizing the sum of squares of differences between the observed responses (values of the variable being predicted) in the given data set and those predicted in a linear function of a set of explanatory variables.

4.3.1 Regression Analysis for Financial Performance

In the present study, a multivariate analysis is conducted to examine the linear relationship between financial performance and its determinants. Financial performance is calculated by ROA (return on assets). The independent variables are environmental, social and governance. The control variables are firm size, leverage and firm age.

$$ROA = \alpha + \beta_1 ENV + \beta_2 SOC + \beta_3 GOV + \beta_4 LEV + \beta_5 SIZE + \beta_6 AGE + \epsilon_{i,t}$$

Model 4.1 provides the association between dependent and independent variable for financial performance of non-financial firm operating in Pakistan. Financial performance is calculated by ROA (return on assets). ENV is environmental determinants, SOC is social determinants and GOV is governance determinants of ESG. LEV is leverage, SIZE is firm size and AGE is firm age. α is intercept and β is slope while ϵ is error term.

4.3.2 Regression Analysis for ROA

Table 4.7 presents the regression result for financial performance. The number of observation is 650. The model fitness is determined through R-squared and F-value. The R-squared value is 0.207, representing that 20% of the total variation in the financial performance of non-financial firms is accounted by independent variables. The results of F-value show that overall model is significant at 1% and can be used for further analysis. Environmental, social, firm size and firm age shows significant and positive relationship with ROA. It means that environmental, social governance and firm age increase the financial performance. SIZE shows negative and significant relationship with ROA. It means firm size decreases the financial performance for non-financial firms of Pakistan. Leverage shows insignificant results.

Table 3: Regression Analysis for ROA

ROA	Coef.	St.Err.	P-value
ENV	.869***	.271	.001
SOC	1.44***	.397	0
GOV	.055**	.046	.028
LEV	-.637	.598	.287
SIZE	-.004*	.025	.086
AGE	.32**	.63	.012
R-squared	0.207	Number of obs	650.000
F-test	9.32	Prob > F	0.000

This table presents the regression analysis for ROA. Financial performance is calculated by ROA. The independent variables are environmental, social and governance. The control variable for the study are LEV(leverage) SIZE (firm size) and AGE (firm age). *, **, *** represents statistically significant at 10%,5% and 1% respectively.

4.4 Results and Discussion

This research study adopts the ordinary least square (OLS) regression to determine the effect of ESG on financial performance. Table III depicts that environmental social and governance determinants influence the financial performance of firms in Pakistan. The results of environmental, social and governance factors are in line with the stockholder theory, which suggests that ESG activities increase the financial performance of firms. The earlier

studies also present positive association between ESG and financial performance, (Mohammad & Wasiuzzaman, 2021; Ahmad et al., 2020; Muslichah, 2020). The institutional theory suggests that the organization's internal and external environment, governance mechanisms and corporate culture are more effective in achieving all dimensions of sustainability. According to this theory, the organization is like an institution with a common goal. Based on this theory the governance factor plays a vital role in organizational performance. The results of the Velte, (2017) revealed that the Governance factor shows significant financial performance results. Siagian et al. (2013) have also looked at governance mechanism impact on firms' value (such as Tobin's Q and price-to-book ratio). They found that governance increases the firm performance. Good governance increases investors' confidence which results in enhancing the firm value.

The results show that firm size decreases the financial performance. According to Li et al. (2018) and Aggarwal et al. (2010), firm size is negatively related to Tobin's Q. The firm age increases the financial performance. The result also depicts that leverage insignificantly influences financial performance. According to Jamal et al., 2022; Crisóstomo et al. (2011), Aupperle et al. (1985), and Ingram and Frazier (1980), leverage positively promotes ROE and Tobin's Q.

5. Conclusion

Environmental, social, and governance issues are effective phenomena for the accomplishment of a firm's objectives. The basic objective of this research study is to determine the impact of ESG on financial performance in Pakistan. The current study is essential in the following distinctive point. Firstly, the current study examines the significant determinants of ESG that affect firms' financial standing. Secondly, the study highlights the importance of country-level governance.

The present study adopts the sample of available non-financial firms listed on the Pakistan Stock Exchange (PSX) from 2013 to 2022. The current study utilizes accounting-based approach (ROA) for calculating the financial performance. This study applied OLS for the analysis of panel data. The result of the study depicts that environmental, social and governance are significant determinants that influence the financial performance of firms in Pakistan. The results of the study are consistent with the previous empirical literature. The outcomes of the current study are also helpful to the management and policymakers. They manage their resources and invest in ESG activities. In the long run, their financial performance will increase.

5.1 Implications of the Study

The conclusions of the current research study ensure many implications. The current study discovered that ESG factors increase the financial performance of firms operating in developing countries like Pakistan. The current study enhances the literature by studying country-level governance. From a policy perspective, the current study provides guidelines for governments and policymakers to consider country-level governance for better financial performance. The results of the current study assist shareholders and investors in deciding whether to invest in ESG factors or not. Since the study's findings indicated that ESG variables are important for both short- and long-term financial performance. The outcomes of the current study are also helpful to the management and policymakers. They invest in ESG initiatives and manage their resources. Their financial performance will improve with time.

5.2 Future Research Recommendations

It is recommended that a more significant sample period and extra environmental and social factors will be studied for future research. This will support enlightening the influence of additional and complex factors of ESG on financial performance. It is also suggested that the indirect effect of ESG on another variable, such as regulatory quality, will be studied.

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