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Environmental, Social, and Governance (ESG) Practices and Firm Value: Evidence from BRICS Countries

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Abstract

This paper aims to investigate the impact of ESG disclosure on firm value in the context of BRICS countries. The research sample comprises 3560 observations for the 2015–2022 period. We used Refinitiv's ESG rating as a measure to assess the extent of a firm's ESG disclosure comprehensively. The findings suggest that ESG disclosure has a positive impact on firm value. Further analysis shows a variation in the investors' responses to the dimensions of ESG score (environmental, social, and governance scores) regarding the nature of their informational content. Specifically, the results show that investors pay more attention to environmental and social activities. The study's results contribute significantly to the broader discourse on sustainable business practices and their implications for long-term economic growth. Understanding how ESG practices impact firm value within BRICS nations provides investors, policymakers, and businesses with valuable insights.

Keywords: ESG disclosure, Firm value, BRICS countries

1. Introduction

In recent years, there has been a significant shift in the way businesses and investors perceive their roles in society. Beyond profit-making, there is a growing recognition of the need for a more holistic approach that considers the environmental, social, and governance (ESG) aspects of their operations. As financial reporting alone offers an incomplete overview of an organization's performance, there is an essential demand for higher transparency in disclosing nonfinancial data, including quantitative and qualitative aspects (Dhingra et al., 2014).

Stakeholders' expectations regarding businesses have risen, prompting them to consider factors beyond mere financial gains (Abrams et al., 2021). Stakeholders encompass a wide range, including investors, creditors, customers, employees, and both national and international authorities. This heightened stakeholder demand became more pronounced after the 2008/2009 financial crisis (Alareeni and Hamdan, 2020). This crisis, which had far-reaching consequences for the global economy, was triggered by inadequate corporate governance and an emphasis on short-term financial profits. As a result, trust in the ethical conduct of business activities by stakeholders and public interest entities diminished, leading to a call for increased transparency in ESG performance disclosure (Velte, 2017). The growing need for enhanced transparency in

ESG disclosures has prompted global regulatory bodies to introduce diverse reforms concerning ESG practices within the business sector (Abrams et al., 2021). Simultaneously, international standard-setting organizations have advocated for frameworks and reforms to bolster, streamline, and evaluate businesses' ESG performance (Velte, 2019). Therefore, assessing whether these reforms and initiatives hold acknowledgement from investors in the capital market becomes essential.

ESG constitutes a criterion for corporate evaluation, and its roots can be traced back to socially responsible investment (Richardson, 2009). Responsible investing has garnered significant stakeholder attention (Friede et al., 2015). Heightened concerns about environmental sustainability, social impacts, and corporate governance compel companies to integrate responsible investing into their overarching investment decision-making strategies (Guo and Yu, 2022). Notably, there is a growing acknowledgement within the investment community that responsible investing not only aligns with ethical considerations but also carries substantial financial merit (Amel-Zadeh and Serafeim, 2018). This shifting perception has pushed socially responsible investment to a pivotal position for fund managers and asset owners, marking a noticeable change in priorities within the realm of finance (Rastogi et al., 2023).

In the context of rapid economic and societal advancements, the significance of the ESG concept has markedly escalated. Investors are willing to allocate capital to enterprises demonstrating outstanding ESG performance. Furthermore, there is a persistent rise in the demand for corporate ESG data from various stakeholders. ESG factors are progressively emerging as the leading dimensions for appraising the sustainability of entities on a global scale (Yu et al., 2020). Enterprises globally are opting for voluntary involvement in additional ESG practices, implying potential economic benefits derived from these practices (Yoon et al., 2018).

There has been a notable surge in various jurisdictions mandating ESG disclosures in recent decades. This trend is expected to become a global norm due to the increasing international focus on ESG activities (Xu et al., 2021). From an informational standpoint, companies practicing ESG initiatives communicate their internal progress to society, mitigating information asymmetry (Siew et al., 2016). Higher ESG disclosure mitigates information asymmetry between investors and managers, decreasing regulatory costs (Dhaliwal et al., 2011) and reducing the potential for opportunistic managerial behaviour (Eccles et al., 2014). Simultaneously, corporate ESG efforts convey positive signals to internal employees, enhancing job satisfaction and loyalty among the existing workforce (In et al., 2019).

In the external market scope, a company's ESG management practices influence its reputation positively, making it appealing to potential employees at minimal expense. This reputation-building also fosters consumer trust, increasing sales and market presence through customer channels (Weber, 2008; Xie et al., 2019). Firms proactively involved in ESG initiatives draw greater investor interest due to the additional information they provide (Dhaliwal et al., 2011).

A company's strategy toward ESG responsibility is fundamentally rooted in the value generated through ESG practices. This value encompasses both the company's market valuation at a specific moment and the enduring financial performance it engenders over time. Companies are highly motivated to enhance their ESG performance to attract investors and enhance their

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performance in the stock market. On the one hand, expecting a positive impact is reasonable because disclosure narrows information gaps, helping investors understand a company's ESG strengths or weaknesses. On the other hand, ESG disclosures might diminish a firm's value if perceived as insincere or superficial, commonly known as cheap talk or greenwashing (Fatemi et al., 2018). Therefore, examining the market participants' response to ESG practices is essential.

Addressing sustainability challenges is complex, time-intensive, and often entails substantial costs, with immediate financial gains not always apparent (Bocken and Geradts, 2020). Though promising, approaches like innovating business models for sustainability are complex and high-risk endeavours, leading many industry professionals to approach them cautiously (Geissdoerfer et al., 2018). Efforts toward sustainability often involve complex financial decisions, potentially conflicting with a company's short-term fiscal objectives (Bocken and Geradts, 2020). The landscape grows even more intricate as doubts arise about the financial advantages of sustainable practices, prompting business experts to question the economic viability of superior ESG performance (Bansal et al., 2021).

While recognizing the significance of sustainability, companies often hesitate to make significant alterations in their practices due to the ambiguous financial consequences associated with sustainability efforts (Bocken and Geradts, 2020). The existing body of research has generated conflicting findings, causing confusion and inconsistencies in the literature (Fatemi et al., 2018). Therefore, this paper aims to add to the literature by investigating the impact of ESG disclosure on firm value in the context of BRICS countries (Brazil, Russia, India, China, and South Africa). The reason behind choosing these countries is that they are emerging economies representing a significant portion of the global economy. The research sample comprises 3560 observations for the 2015–2022 period. We used Refinitiv's ESG rating as a measure to assess the extent of a firm's ESG disclosure comprehensively. The study findings suggest that ESG disclosure positively impacts firm value. Further analysis shows a variation in the investors' response to the dimensions of ESG score based on the nature of the information they provide. Specifically, the results show that investors pay more attention to environmental and social activities.

This study contributes to the literature in different ways. Examining the influence of ESG disclosure on firm value in BRICS countries holds importance in corporate governance and sustainable development endeavours. These emerging economies, collectively representing a substantial portion of the global market, are undergoing rapid industrialization and economic growth. Therefore, understanding how ESG practices impact firm value within these nations provides investors, policymakers, and businesses valuable insights. It not only aids investors in making informed decisions by considering environmental, social, and governance factors alongside financial metrics but also guides companies in implementing responsible and ethical practices. Moreover, as these countries play a pivotal role in shaping the global economy, studying the relationship between ESG initiatives and firm value in BRICS nations can contribute significantly to the broader discourse on sustainable business practices and their implications for long-term economic stability and social well-being.
We provide empirical findings on the connections between ESG disclosure and market performance within 2015–2022, encompassing the period marked by the COVID-19 pandemic, which triggered a significant economic downturn, leading to substantial declines in stock

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markets. Our findings support the idea that firms demonstrating outstanding ESG performance garner acknowledgement from investors and typically handle crises more adeptly than their peers.

The rest of this paper is organized as follows. Section 2 provides a literature review and hypothesis development. Section 3 introduces the model and research methodology. Section 4 shows empirical results, and finally, section 5 presents the study's conclusion.

2. literature review and hypothesis development

According to the resource-based view of the firm, engaging in environmental or socially responsible initiatives can enhance the managerial skills within a company and improve its ability to attract skilled employees. Additionally, these activities can boost the company's reputation and foster positive relationships with its stakeholders (Bhattacharya et al., 2008; Branco and Rodrigues, 2006).

The rationale behind the impact of ESG disclosure on the firm value is deeply rooted in the principles of transparency, accountability, and long-term sustainability. When companies voluntarily disclose their environmental, social, and governance practices, they provide crucial information to stakeholders. Investors increasingly recognize that ESG factors are integral to assessing a company's risk profile and prospects. ESG disclosure fosters trust and confidence among investors, indicating a company's commitment to ethical practices and responsible management (Fatemi et al., 2018). Moreover, it aligns businesses with evolving societal expectations, demonstrating adaptability and foresight. This alignment with broader social and environmental goals can enhance a firm's reputation, attract socially responsible investors, and reduce the potential risks associated with ESG issues. Consequently, the transparency provided by ESG disclosure enhances stakeholder relations and contributes significantly to a firm's long-term value and resilience (Malik, 2015; Fatemi et al., 2015).

Companies operate within a network of relationships involving various stakeholders, including investors, employees, customers, and the community. To explain the connection between ESG activities and firm performance, stakeholder theory is frequently employed. This theory elucidates the alignment of interests between companies and their diverse stakeholders, illustrating how these alignments contribute to the objective of maximizing value and fostering competitive advantages. Stakeholder theory emphasizes transparent communication between a company and its stakeholders (Freeman, 1984). ESG disclosure becomes a strategic tool for fostering trust, engagement, and long-term stakeholder relationships. By openly sharing information about their ESG initiatives, companies demonstrate their commitment to sustainable practices, which can enhance stakeholder satisfaction, mitigate risks, and ultimately contribute to value creation in the long term. Moreover, this disclosure fosters a sense of accountability, aligning the company's goals with societal and environmental needs, thus establishing a foundation for responsible and ethical business conduct (Fatemi and Fooladi, 2013).

Deciding to disclose ESG information voluntarily necessitates a careful balance between the associated expenses, such as compliance costs, and the potential advantages, such as enhanced access to financial resources or increasing firm value (Xu et al., 2021). Within the framework of voluntary disclosure theory, it can be posited that a company's involvement in ESG initiatives

predicts its ESG reporting behaviour. Companies with favourable ESG records report extensively on their ESG practices, while those with less favourable records opt for minimal disclosure. This pattern allows the firm to signal its ESG performance, distinguishing itself from weaker performers and mitigating the effects of adverse selection (Verrecchia, 1983). On the other hand, companies might utilize ESG reporting as a strategic tool to shape public opinion. They could amplify their disclosures to counteract or mitigate the adverse impact of significant environmental incidents or similar events on their reputation and market value (Cho and Patten, 2007; Brown and Deegan, 1998). Alternatively, increased disclosure could serve as a means to restore the company's legitimacy following such incidents (Deegan, 2002; Campbell et al., 2003). Moreover, a company might strive to present a facade of greater ESG awareness than it genuinely possesses "greenwashing"(Yang, 2022).

Previous research lends support to the positive impact of ESG practices. For example, Li et al. (2018) investigated how ESG reporting influences firm value. Their findings indicate a positive connection between the extent of ESG reporting and firm value. Pedersen et al. (2021) suggest that investors sensitive to ESG issues tend to avoid investing in companies with low ESG ratings. Velte (2017) finds a positive association between ESG performance and profitability among German companies. Roy et al. (2022) show that companies mandated to adhere to CSR practices experience enhanced stock market liquidity, leading to higher market valuations over the long term. Fatemi et al. (2018) explored the impact of ESG activities and their disclosure on a company's value. The study reveals that strong ESG practices enhance firm value, while shortcomings diminish it. Significantly, the study underscores the pivotal role of disclosure as an essential moderator. It not only alleviates the adverse impact of weaknesses but also attenuates the positive influence of strengths on firm value. Chung et al. (2023) examined the effect of ESG disclosure on a company's financial performance within Hong Kong's mandatory disclosure framework. The study reveals a significant and positive relationship between the overall level of ESG disclosure and the firm's financial performance. Ademi and Klungseth (2022) explored the association between a company's ESG performance and its market value and financial performance. The study concentrates on firms listed in the S&P 500 index, encompassing a total of 5,750 observations spanning the period from 2017 to 2020.The empirical findings indicate that companies exhibiting superior ESG performance demonstrate stronger financial performance and receive higher market valuations than their industry counterparts. Given the preceding discourse, we posit the subsequent hypothesis:

H1. There is a positive relationship between ESG disclosure and firm value

3. Model and methodology

3.1 Sample

The research sample comprises companies from BRICS countries. The sample contains 3560 observations for the 2015–2022 period, after excluding financial firms and firms that do not have available data. We use Refinitiv's ESG disclosure score as a measure to assess the extent of a firm's ESG disclosure comprehensively. The accounting and market data used to measure variables comes from the Refinitiv database. Table (1) presents the sample distribution by industry and country. As shown in table (1), the selected firms belong to ten different sectors. Moreover, from the geographical point of view, the selected companies belong to five countries:

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Brazil, Russia, India, China, and South Africa.

Table 1. Sample distribution

Panel A. Sample distribution by industry			Panel B. Sample distribution by country		
	Number	(%)		Number	(%)
Utilities	280	7.87	Brazil	480	13.48
Basic materials	544	15.28	Russia	224	6.29
Consumer stables	328	9.21	India	640	17.98
Energy	320	8.99	China	1552	43.60
Health care	288	8.10	South Africa	664	18.65
Industrials	768	21.57			
Telecommunications	152	4.27			
Consumer discretionary	488	13.71			
Real estate	224	6.29			
Technology	168	4.72			
	3560	100%		3560	100%

Note: This table presents the sample's distribution. Panel (A) presents the sample distribution by industry, while Panel (B) presents the sample distribution by country.

3.2 Variables measurement

3.2.1 Independent variable

We use ESG rating by Refinitiv as a proxy for ESG disclosure. Refinitiv offers a comprehensive ESG dataset from 2002, making it one of the most extensive in the market. This dataset evaluates firms' ESG performance across ten themes and three pillars, incorporating over 600 criteria.

3.2.2 Dependent variable

Tobin's Q is commonly used as a proxy for firm value. Following prior studies in this field, we use Tonin's Q to measure firm value (Fatemi et al., 2018; Ademi and Klungseth, 2022; Velt et al., 2017; Lu et al., 2023). Tobin's Q is the ratio of the market value of the company to its intrinsic value. It is calculated by dividing the firm's market value by the cost required to replace its assets.

3.2.3 Control variables

The study uses a set of control variables to ensure the reliability of our model based on the previous studies in this field of literature (Fatemi et al., 2018; Lu et al., 2023; Ademi and Klungseth, 2022; Abrams et al., 2021). These variables include firm size, leverage, return on assets, CSR committee, and sales growth. Table (2) provides variables measurement.

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3.3 Model Specification

We employ the following model to examine the association between ESG disclosure and firm value.

$$TobinQ_{it} = \beta_0 + \beta_1 ESG_{it} + \beta_2 SIZE_{it} + \beta_3 LEV_{it} + \beta_4 ROA_{it} + \beta_5 CSRcom_{it} + \beta_6 SalesGro_{it} + \sum INDUSTRY_i + \sum COUNTRY_i + \sum YEAR_i + \varepsilon_{it}$$

Table 2. Variables definition

Variable	Acronym	Measurement
Dependent variable:		
Tobin's Q	TobinQ	The market value of equity plus total liabilities divided by total assets.
Independent variable:		
ESG disclosure	ESG	Refinitiv's rating of ESG disclosure.
Control variables:		
Firm size	SIZE	The natural logarithm of total assets.
Leverage	LEV	The ratio of debt-to-total assets.
Return on assets	ROA	Net income divided by total assets.
CSR committee	CSRcom	A binary variable takes one if the committee exists and zero otherwise.
Sales growth	SalesGro	Sales at year t / sales at year (t-1) -1.

4. Empirical results

4.1 Descriptive statistics

The descriptive statistics of the sample are displayed in Table (3). The dependent variable, represented by Tobin's Q, has a mean value of 1.859 with a minimum and maximum value of 0.628 and 8.122, respectively, and a standard deviation of 1.515. Whereas the independent variable represented by ESG has an average of 47.414 with minimum and maximum values of 12.360 and 91.020, respectively, and a standard deviation of 18.745, this suggests a variation amongst the firms' ESG score. For control variables, Table (3) shows that the mean value of firm size (SIZE), leverage (LEV), return on assets (ROA), CSR committee (CSRcom), and sales growth (SalesGro) is 15.634, 0.540, 0.088, 0.618, and 10.348 respectively.

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Table 3. Descriptive Statistics

Variable	Obs.	Mean	Std. Dev.	Min	Max
TobinQ	3560	1.859	1.515	0.628	8.122
ESG	3560	47.414	18.745	12.360	91.020
SIZE	3560	15.634	1.405	12.746	18.784
LEV	3560	0.540	0.190	0.171	0.912
ROA	3560	0.088	0.082	-0.090	0.343
CSRcom	3560	0.618	0.486	0	1
SalesGro	3560	10.348	20.071	-33.51	69.840

Note:TobinQ = Tobin's Q; ESG = ESG disclosure score; SIZE = firm size; LEV = leverage; ROA = return on assets; CSRcom = CSR committee; SalesGro = sales growth.

The result of Pearson's correlation is presented in Table (4). Table (4) shows that the correlation between Tobin's Q and ESG disclosure is positive and significant at a confidence level of 95%. This means that higher ESG disclosure enhances firm value. In addition, Tobin's Q positively correlates with ROA and sales growth. It has a negative and significant correlation with firm size and leverage. While the correlation between Tobin's Q and the CSR committee is positive, it is not significant. In addition, the correlation coefficients, as displayed in the correlation matrix in Table (4), show that the variables in the model are free from the problem of multi-collinearity because the correlation coefficients amongst the independent variables are less than 0.80.

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Table 4. Pearson's correlation results

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)
(1) TobinQ	1.000						
(2) ESG	0.042**	1.000					
(3) SIZE	-0.335***	0.106***	1.000				
(4) LEV	-0.303***	0.049***	0.269***	1.000			
(5) ROA	0.538***	0.126***	-0.187***	-0.395***	1.000		
(6) CSRcom	0.001	0.474***	-0.087***	0.059***	0.049***	1.000	
(7) SalesGro	0.096***	0.038**	0.072***	-0.009	0.259***	-0.028*	1.000

Note: This table presents person correlation results. TobinQ = Tobin's Q; ESG = ESG disclosure score; SIZE = firm size; LEV = leverage; ROA = return on assets; CSRcom = CSR committee; SalesGro = sales growth. *** $p<0.01$, ** $p<0.05$, * $p<0.1$

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4.2 Regression results

Table (5) clarifies the results of the OLS regression. The findings show that ESG disclosure has a significant positive impact on Tobin's Q (0.012, p<0.01). This implies that ESG disclosure enhances the firm's information environment, generating positive reactions from market participants. This finding supports the signalling theory, which posits that ESG disclosure signals the market about a company's commitment to responsible practices, influencing investors' perceptions and decisions. Accordingly, our research hypothesis is accepted, meaning that ESG disclosure enhances firm value. The result of this study is in line with the prior literature in this field (Ademi and Klungseth, 2022; Fatemi et al., 2018; Li et al., 2018; Roy et al., 2022).

Our results for the control variables reveal that firm size negatively influences Tobin's Q, and the effect is significant (-0.416, p<0.01). ROA has a significant positive relationship with Tobin's Q (7.485, p<0.01). This implies that an increase in profitability increases firm value. Sales growth positively relates to Tobin's Q (0.002, p<0.10). The relationship between Tobin's Q and LEV and the CSR committee is not significant.

Table 5. Regression results

VARIABLES	TobinQ
ESG	0.012***
	(9.71)
SIZE	-0.416***
	(-23.42)
LEV	-0.131
	(-1.24)
ROA	7.485***
	(29.04)
CSRcom	-0.021
	(-0.46)
SalesGro	0.002*
	(1.65)
Constant	6.782***
	(24.97)
Industry effect	Yes
Country effect	Yes
Year effect	Yes
Observations	3,560
Adj R-squared	0.553

Note: This table presents the OLS regression results of the model. TobinQ = Tobin's Q; ESG = ESG disclosure score; SIZE = firm size; LEV = leverage; ROA = return on assets; CSRcom = CSR committee; SalesGro = sales growth. T-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

4.3 Robustness check

To check the robustness of our results, we use the market-to-book value as an alternative measure of the firm value. The results of the alternative measure appear in Table (6). The findings show that ESG disclosure positively influences firm value (0.031, p<0.01). This result reaffirms our main results and lends support to our hypothesis.

Table 6. An alternative measure of firm value

VARIABLES	MTBV
ESG	0.031***
	(9.25)
SIZE	-1.054***
	(-21.98)
LEV	4.175***
	(14.63)
ROA	16.063***
	(23.10)
CSRcom	0.207*
	(1.70)
SalesGro	0.005**
	(2.13)
Constant	13.351***
	(18.22)
Industry effect	Yes
Country effect	Yes
Year effect	Yes
Observations	3,560
Adj R-squared	0.397

Note: This table presents the regression results of the alternative measure of firm value. MTBV = market to book value; ESG = ESG disclosure score; SIZE = firm size; LEV = leverage; ROA = return on assets; CSR com = CSR committee; Sales Gro = sales growth. T-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

4.4 Additional analysis

We perform additional analysis to assess the impact of the components of ESG score (environmental, social, and governance scores) on the firm value. Further analysis is required to comprehensively evaluate the influence of individual ESG components on market performance. Specifically, it is crucial to delve into the distinct effects of each of the three ESG elements on a company's market value. This exploration is vital in gaining insights into whether a company's performance in any of these ESG dimensions carries more significant weight in shaping its market outcomes than the others. The results of the additional analysis are shown in Table (7). The findings show a variation in the influences of the components of ESG score on the firm

value. Specifically, table (7) model (1) reveals that environmental disclosure score (ENDISC) positively influences Tobin's Q (0.005, p<0.01). Model (2) shows that the social disclosure score (SODISC) is positively related to Tobin's Q (0.007, p<0.01). However, Model (3) reveals that the relationship between the governance disclosure score (CGDISC) and Tobin's Q is insignificant.

Table 7. Regression results of the components of ESG score

VARIABLES	(1) TobinQ	(2) TobinQ	(3) TobinQ
ENDISC	0.005***		
	(5.55)		
SODISC		0.007***	
		(6.82)	
CGDISC			0.001
			(1.22)
SIZE	-0.391***	-0.395***	-0.358***
	(-21.76)	(-22.29)	(-21.05)
LEV	-0.157	-0.150	-0.177*
	(-1.47)	(-1.40)	(-1.65)
ROA	7.635***	7.546***	7.752***
	(29.43)	(29.05)	(29.86)
CSRcom	0.039	0.021	0.094**
	(0.86)	(0.46)	(2.12)
SalesGro	0.002*	0.002*	0.001
	(1.78)	(1.71)	(1.57)
Constant	6.731***	6.661***	6.356***
	(24.17)	(24.36)	(23.40)
Industry effect	Yes	Yes	Yes
Country effect	Yes	Yes	Yes
Year effect	Yes	Yes	Yes
Observations	3,560	3,560	3,560
Adj R-squared	0.545	0.547	0.541

Note: This table presents the regression results of the ESG components' models. TobinQ = Tobin's Q; ENDISC = environmental disclosure score; SODISC = social disclosure score; CGDISC = governance disclosure score; SIZE = firm size; LEV = leverage; ROA = return on assets; CSRcom = CSR committee; SalesGro = sales growth. T-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1.

5. Conclusion

This study explored the influence of ESG disclosure on firm value within the BRICS countries context. The study results indicate a positive effect of ESG disclosure on firm value. Additionally, in-depth analysis revealed varying investor reactions to the dimensions of the ESG score (environmental, social, and governance scores), highlighting the diverse informational

content within these dimensions. Specifically, the results show that investors pay more attention to environmental and social activities. Our results align with stakeholder theory, indicating that stakeholders positively view the disclosure and implementation of outstanding ESG practices. This fosters strong relationships and trust with stakeholders, which in turn results in favourable recognition in the stock market. The established trust and relationships with stakeholders, facilitated by robust ESG practices, often contribute to the company's sustained positive market performance.

The boundaries of this study provide opportunities for future research to delve into the mechanisms through which ESG practices impact a company's value. Additionally, as this research focuses on BRICS countries, exploring similar inquiries in different contexts could further enrich this study area.

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