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Environmental, Social, and Governance Performance and Value Creation in Product Market: Evidence from Emerging Economies

Yasmeen Bashir [1], Yiwei Zhao [2], Huan Qiu [3,*], Zeeshan Ahmed [4] and Josephine Tan-Hwang Yau [1]

1 School of Business & Management, University of Malaysia Sarawak, Kota Samarahan 94300, Malaysia
2 College of Business & Economics, Longwood University, Farmville, VA 23909, USA
3 Else School of Management, Millsaps College, Jackson, MS 39210, USA
4 Department of Accounting and Finance, Capital University of Science and Technology, Islamabad 44000, Pakistan
* Correspondence: qiuh@millsaps.edu

Abstract: Using a unique sample of 13,412 firm-year observations from 19 countries of the emerging economies for the period of 2011 to 2019, we investigate the association between the firms' environmental, social, and governance (ESG) performance and their value creation in the product market. Specifically, we first used the pooled OLS regression model for panel data as our baseline model and found that ESG performance (as well as its pillars) has a strong positive effect on the future value creation of the firms in the product market. We also conducted some additional analyses using various regression models, as well as adopting multiple tests for endogeneity, and the additional analyses revealed that the results are robust under different scenarios. Overall, the findings of this study highlight the importance of firm-level ESG performance for the value creation of firms in the product market in emerging economies and have theoretical and practical implications for academic researchers, market participants, and government entities in studying, evaluating, and governing firms' ESG performance and reporting.

Keywords: ESG; value creation; product market; emerging economies

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1. Introduction

The assessment of a firm's environmental, social, and governance (ESG) performance has garnered considerable importance in scholarly investigations, the current corporate environment, and real-world implementation. The rise in the significance of this phenomenon has received growing attention from stakeholders at both national and international levels (Mohammad and Wasiuzzaman 2021; Wu et al. 2022).

ESG performance is defined as an organization's relationship with its ecological surroundings, as well as its coexistence and interaction with other populations and human organisms.[1] It also supports businesses in controlling their internal systems of rules and regulations to serve the interests of shareholders and other interest groups (Whitelock 2015). Participation in environmental, social, and governance (ESG) activities can potentially benefit firms by lowering the cost of capital and improving the reputation of the firms (Bhattacharya and Sharma 2019; Gennari and Salvioni 2019). Furthermore, actively engaging in ESG activities can help firms foster "trustful" relationships with a variety of stakeholders, including staff members, consumers, investors, local communities, environmental advocates, and concerned citizens. The aforementioned linkages play a crucial role in supporting the continuous performance, financial stability, and ability to generate value of the firms (Brooks and Oikonomou 2018; Freeman 2017; Li et al. 2018).

Customers and communities place notable emphases on the disclosure policies of firms regarding their ESG considerations. The assessment of a firm's standing as a responsible corporate entity is frequently determined by the evaluation of the disclosed ESG information. The aforementioned perception can exert a direct influence on the customers' behaviors and the community's attitudes, along with the investors' investment decisions, towards the firm. Compared to "traditional" firms, investors normally view firms with appropriate ESG strategies as long-term investment targets (Mohamad 2020; Mohammad and Wasiuzzaman 2021; Sadiq et al. 2020; Van Duuren et al. 2016; Yip and Lee 2018).

Similarly, consumers who consider a firm as a responsible and ethical entity are more likely to purchase its products or services. The heightened level of patronage has the potential to result in amplified sales and revenue for the corporation inside the product market. As a result, the firm can attain higher levels of profitability, thereby making a significant contribution to its overall value creation (Fuentes-García et al. 2008).

Numerous prior studies reveal a direct link between "ESG and Firm Value", but the studies base their findings on samples from developed economies with more sophisticated financial markets (Alsayegh et al. 2020; El Khoury et al. 2021; Harjoto and Jo 2015; Mohamad 2020; Plumlee et al. 2015; Yadav et al. 2016; Yordudom and Suttipun 2020). A small number of studies have focused on emerging markets (Azmi et al. 2021; Malarvizhi and Matta 2016; Siagian et al. 2013), but not even a single study has been conducted in the product market, which is crucial to a firm's ability to create value (Fresard 2010).

This study attempts to fill this gap by investigating the association between "ESG and firm value" in the product market of emerging economies. Emerging economies are considered as a global economic engine in the twenty-first century because of their low leverage, limited penetration of goods and services, and demographic dynamics. It is reasonable to assume that firms in an emerging market will engage in more ESG activities to achieve sustainable growth. Simultaneously, many of these countries have to deal with significant challenges, such as poverty, pollution, corruption, inadequate physical and social infrastructure, governance issues, political instability, poor consumer protection, and a lack of product standards (Behl et al. 2021). Hence, instead of becoming involved in social issues including the environment and society, businesses in emerging markets prioritize operating efficiency and profit maximization (Teoh and Thong 1984; Yoon et al. 2018), and consequently, firms may lose their social capital and worth in the product market due to the damage to their reputation and the loss of trust from customers (Sadiq et al. 2020). Overall, the association between ESG and firm value in the product market of the emerging economies is an empirical question.

To further study this topic, we first collected the ESG and other firm-level financial information of the firms from 19 countries of the emerging economies for the period of 2011 to 2019 from the Thomson Reuters Datastream dataset.[2] We next obtained country-level economic data from the World Bank open dataset. In the last step, we merged all the datasets, deleted the observations with missing values for variables required in the regression, as well as the observations in finance (SIC codes 6000–6999) and utility (SIC codes 4000–4999) industries, and formed our final dataset for the empirical study.

We first investigated the association between a firm's ESG performance and value creation in the product market and found a strong positive association between the two variables in our baseline model. To ensure that our results were robust, we re-examined the topic using various regression models, as well as tests for endogeneity, and we found that the strong positive association between ESG performance and value creation holds under different scenarios.

Our study makes several contributions to the literature. First, we confirm the findings from the extant ESG literature that firms' ESG performance has a positive effect on the value creation of the firms in the future (Alsayegh et al. 2020; El Khoury et al. 2021; Harjoto et al. 2015; Mohamad 2020; Plumlee et al. 2015; Yadav et al. 2016; Yordudom and Suttipun 2020), thus lending support to the theories that predict the positive association between the two items (e.g., stakeholder theory and the resource-based view theory).[3] Additionally, we contribute to the ESG literature by identifying the positive influence of ESG on value creation in the product market. Our empirical evidence implies that firms' ESG performance helps attract customers to consume the products or services provided