

The Positive Role of ESG in Enhancing Corporate Value and Its Functional Mechanism

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Abstract. In recent years, ESG has evolved into a tool for managing systemic risk and a new driver of value creation, while global ESG assets have grown rapidly. This has enabled an increasing number of enterprises to recognize the importance of ESG to corporate value. However, most enterprises still remain in the wait-and-see stage and have not carried out substantive ESG investment. To improve enterprises' willingness to invest in ESG assets, this paper studies China's A-share listed companies using a literature review. It collects relevant studies on "ESG and corporate value" from CNKI and Web of Science, from which it identifies key differences and agreements in existing research. Besides, it summarizes how ESG contributes to corporate value. The results show that strong environmental, social, and governance (ESG) performance improves firms' financial conditions, eases financing constraints, supports innovation, and strengthens risk management. In addition, mechanism analysis suggests these effects operate through three channels: stronger reputation and brand equity, more efficient capital allocation, and better talent attraction and productivity.

Keywords: ESG Performance, Corporate Value, Positive Effect, Mechanism of Action

1. Introduction

As green and sustainable development has become widely accepted, the international community has reached top-level consensus on addressing climate change, promoting resource conservation and fulfilling social responsibilities, and relevant regulatory policies have also become increasingly stringent and institutionalized. Against this backdrop, ESG (Environmental, Social, and Governance) has emerged as a prominent focus in both academic research and corporate practices globally. In this context, a growing body of research indicates that ESG embodies corporate social responsibility, boosts the long-term value of enterprises, and reduces short-term oriented behaviors by improving corporate governance structures and strengthening the implementation of environmental and social responsibilities. Although many studies find a positive or non-negative link between ESG and firm value, the internal transmission mechanism is still not well explained. Through a literature analysis method, this paper reviews existing research on the relationship between ESG and corporate value. In particular, it synthesizes core perspectives from existing studies and focuses specifically on the positive impact of ESG on corporate valuation. On this basis, this paper explores the transmission mechanism through which ESG affects corporate value, covering financial performance, innovation capability, risk management, investor confidence, and

corporate reputation. Furthermore, analysis of these mechanisms helps explain how ESG creates value, provides a basis for investors to identify high-potential firms, and supports more effective investment decisions, hence enhancing long-term corporate value.

2. Concepts and characteristics of ESG and corporate value

2.1. The concept and characteristics of ESG

ESG is a key indicator system for measuring corporate sustainable development capacity, consisting of three core dimensions, covering Environment (E), Social (S), and Governance (G). Specifically, the environmental dimension primarily focuses on corporate practices in addressing climate change, resource consumption, as well as pollution and waste management. In contrast, the social dimension focuses on how enterprises handle relations with employees, suppliers, customers, and communities, covering data privacy protection, labor standards and product safety. In addition, the governance dimension includes corporate leadership structure, shareholder rights, executive compensation, internal control and business ethics. Notably, unlike traditional financial indicators, ESG reflects corporate social responsibility and captures firms' long-term value and risk resilience.

2.2. The concept and characteristics of corporate value

Enterprise value reflects an enterprise's overall economic worth and its market valuation as a going concern. Unlike financial indicators such as profit that reflect the short-term operating conditions of an enterprise, enterprise value can reflect the long-term development prospects of an enterprise from a more long-term perspective. Accordingly, it offers a broader framework than short-term financial indicators in evaluating corporate performance. At the macro level, factors influencing corporate value encompass gross domestic product and its fluctuations, shifts in economic cycles, and relevant national policies. From the perspective of industry development, enterprise value is primarily affected by the industry development prospects and the enterprise's position within the industry. Besides, from an internal perspective, brand value, enterprise scale, asset status, earnings performance, business strategies, incentive mechanisms, and changes in senior management are all critical factors affecting enterprise value [1]. Accordingly, corporate value is affected by the joint interaction of multiple factors. Among them, research on the impact of ESG on corporate value has been steadily increasing.

3. The positive impact and functional mechanism of ESG on corporate value

3.1. The positive impact of ESG on corporate value

Existing studies generally find that strong ESG performance enhances corporate value through three main channels: financial performance, innovation capability, and risk management.

Specifically, sound ESG performance contributes to the improvement of corporate financial performance. Research findings indicate that ESG is generally positively correlated with corporate financial performance. Based on resource dependence theory, Bostian et al. argue that enterprises with sound ESG performance can optimize capital allocation and improve financial performance [2]. Goss et al. found that enterprises with high ESG ratings face lower financing costs, which further enhances financial performance [3]. From the perspective of individual dimensions, environmental responsibility enables energy conservation and emission reduction, lowers compliance costs, and boosts revenue through reputation effects. Besides, social responsibility strengthens trust between

firms, customers, and employees, thus stabilizing operating income. Moreover, improved corporate governance reduces agency costs and improves operational efficiency. Empirically, Zhang finds a significant positive association between ESG performance and corporate financial performance among A-share listed firms in China from 2014 to 2023 [4].

In this context, ESG promotes corporate innovation. Research on corporate social responsibility (CSR) shows that integrating social responsibility into executive incentive mechanisms increases innovation output, as it boosts employees' innovation vitality and managers' risk-taking incentives while reducing innovation-related agency costs [5]. At the same time, environmental responsibility drives green production and eco-friendly product development; social responsibility improves stakeholder relationships and provides resources and information for innovation; and improved corporate governance curbs short-termism and encourages long-term innovation investment. On this basis, ESG greatly promotes corporate innovation investment by enhancing corporate reputation, alleviating financing constraints, and reducing operational risks [6]. Furthermore, firms with strong ESG performance exhibit stronger risk management capabilities. During economic downturns, they can rely on trust-based stakeholder relationships to obtain support, buffer external shocks, and reduce potential losses [7]. Empirical studies demonstrate that ESG performance is significantly negatively correlated with corporate risks, indicating that better ESG performance is associated with lower risk [8].

3.2. The mechanism underlying the positive impact of ESG on corporate value

ESG exerts both direct and indirect effects on corporate value. In particular, the direct effects are reflected in improvements in financial performance, innovation, and risk management. In contrast, the indirect effects operate through enhanced investor confidence, improved corporate reputation, optimized capital allocation, and stronger talent attraction, promoting long-term corporate value. Notably, the indirect channel is particularly prominent.

First, ESG enhances corporate value by strengthening investor confidence. Firms with strong ESG performance can signal a positive image to investors, raise expectations of future performance, and thereby encourage favorable investment decisions [9]. As ESG ratings increasingly serve as a key financial reference, investors place greater emphasis on and show higher willingness to invest in high-ESG firms, which further enhances corporate value [10]. Second, ESG improves corporate reputation and brand value. Strong ESG performance signals that a firm fulfills environmental and social responsibilities and maintains sound relationships with stakeholders, thereby building a stable long-term reputation. Such reputation not only boosts sales, revenue, and market share, but attracts capital investment, thus enabling firms to undertake value-enhancing projects and accelerate growth [11, 12]. Third, ESG improves investment and capital allocation efficiency. In contrast to traditional short-term oriented decisions focused on profits and earnings per share, ESG-oriented firms rely on stronger governance, reputation, and corporate culture to support long-term stability and resilience. Although these intangible assets may have limited short-term impact, they underpin long-term development. Amid the global low-carbon transition, high-ESG firms also reduce adjustment costs and improve operational efficiency, enabling faster adaptation to environmental changes. Finally, ESG enhances talent attraction and productivity. Firms that perform well in ESG are more likely to recruit value-aligned, high-quality employees, and a greater sense of social responsibility among staff also boosts productivity. In technology-intensive ESG transformation projects, such firms are also more likely to attract core technical talent, thereby providing crucial human capital support for long-term innovation, transformation, and development [13].

4. Existing challenges and future development directions of ESG

4.1. Key challenges facing ESG

ESG rating divergence has become an increasingly important issue in current practice. At present, discrepancies remain between international frameworks like ISSB and GRI and China's ESG rating standards. In addition, the continuous expansion of information disclosure has further contributed to divergent ESG assessment outcomes for the same enterprise across different rating agencies. Such divergence not only undermines the extent to which ESG data can accurately reflect firms' true sustainability performance, but also reduces investors' decision-making efficiency and willingness to invest, while also exacerbating information asymmetry. Against this backdrop, firms may face heightened financing constraints and distorted managerial incentives, whereas investors are more exposed to the risks of adverse selection and moral hazard. Meanwhile, corporate greenwashing has become increasingly prevalent. Some firms overstate environmental performance or distort ESG information to present an appearance of sustainability, despite lacking substantive environmental action. Such behavior not only fails to improve genuine environmental outcomes, but also generates dual negative impacts on both firms' financial performance and corporate reputation [14]. Moreover, ESG performance shows significant regional and industry heterogeneity. However, existing studies are still largely concentrated on developed economies, with limited attention paid to developing countries, especially in terms of institutional and industrial heterogeneity.

4.2. Future development directions of ESG

ESG rating divergence can be addressed through a range of coordinated measures. At the policy level, the government should further improve the regulatory framework for information disclosure, develop an ESG rating system with Chinese characteristics, and establish a specialized regulatory body to strengthen oversight. At the corporate level, firms should enhance the transparency of ESG disclosures and formulate clear ESG objectives and implementation strategies. Moreover, rating agencies should strengthen cross-industry comparability, incorporate more quantitative indicators, and continuously refine their rating methodologies [15]. Also, evidence shows that environmental regulation improves corporate compliance [16]. Therefore, command-and-control regulation should be tightened via laws and technical standards to limit emissions and curb greenwashing. In addition, market-based instruments should be expanded to internalize environmental costs, promote emission cuts, and balance economic growth with environmental protection [17, 18]. Given the regional and industrial heterogeneity of ESG performance, efforts should be made to improve the consistency of top-level policy design, promote mutual recognition of international standards, and develop industry-specific, tiered evaluation systems. Besides, data sharing and real-time monitoring should be strengthened to enhance the dynamic responsiveness of ESG assessment systems. In addition, greater efforts are needed to promote the dissemination of the ESG concept, raise awareness across society, and encourage enterprises to accelerate their transition toward ESG-oriented operations.

5. Conclusion

With the deepening integration of ESG into corporate practice, environmental protection, social responsibility, and corporate governance have become core to firms' long-term development, while ESG has emerged as an important measure of sustainable value. Accordingly, results suggest that strong ESG performance improves financial conditions, promotes innovation investment, enhances

risk management, and increases firm value. Moreover, ESG supports long-term value creation via several channels, including stronger corporate reputation and brand equity, better investment and capital allocation, and the attraction of high-quality talent with higher employee productivity. These mechanisms indicate that ESG is not only a manifestation of corporate social responsibility but also an endogenous driver of sustainable development, enabling more efficient allocation of resources and higher-value returns from limited inputs. In the context of green development, firms should mainstream ESG into strategy and operations. By advancing low-carbon development, fulfilling social responsibilities, and improving governance, enterprises can achieve long-term value growth while limiting short-term risks.

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