

Relationship Between ESG Scores and Profitability of Selected Indian Companies

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Abstract

This research work is a comprehensive analysis of the correlations between Environmental, Social, and Governance concerns as reported in the corporate world and the profitability of such companies in India. In particular, it evaluates whether the higher ESG scores are a leading indicator of better financial results. Through multivariate regression modelling, data was collected on 150 companies representing 10 major sectors for three years. The purpose was to understand the impact of ESG aggregate score on Return on Assets, while factors like firm size and leverage were also brought into consideration. The results account for a notably positive association, thereby confirming that higher ESG effectiveness goes hand-in-hand with enhanced profitability. In contrast, firm size portrays a strong negative relationship with profitability, thus firm seems to have reached the limit of its economies of scale. Additionally, leverage, in comparison, exercises a minor role, a sign that debt level is not a major driving force of profitability in the group of firms sampled. Industry-wise, the effect of ESG activities varies across different areas of business. For example, sectors such as Fast-Moving Consumer Goods and construction, which are resource-intensive, reveal that they have more disclosure shortcomings compared to the Information Technology and financial services sectors that have advanced their reporting practices. In addition to that, the study finds that there is a big gap: even though governance reporting is strong, environmental disclosure is still weak in all sectors. The results reveal that sustaining the environment can be seen as the main factor that drives the company's advantage over the competition rather than just requirement of compliance, especially in industries that are heavy on capital and sensitive to investors. The variation in performance across different industries points to the need for different policy interventions in each sector. The interventions should be mainly through enhancing incentives for sectors that are low in social and environmental transparency. Furthermore, the difference between environmental disclosures and governance reporting emphasizes the urgent need for an integrated reporting framework that gives priority to solid quantitative environmental metrics. As a result, transparent ESG activities are the foundation of continued financial success, thus the need for a strategic focus on elevating environmental transparency and establishment of sector-specific sustainability initiatives is what the study concludes.

Keywords

ESG (Environmental, Social, and Governance), Indian Companies, Profitability, Return on Assets (ROA), Sustainability Reporting.