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Research Article

ESG in the Sustainability Report and the Impact on Investors' Choices: A Literature Review

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Abstract

The literature highlights an increase in interest in information on sustainability and CSR policies and highlights an increase in the number of sustainable and responsible investments. Although there are already studies that analyse the impact of ESG on Stakeholders, but more work must be carried out in this area. The main objective of this article is to understand whether there is evidence to prove the relationship between the inclusion of Environmental, Social, and Governance (ESG) in the Sustainability Report and the impact on investors' choices. In this sense, it seeks to demonstrate through the literature review that companies that publish non-financial information through ESG ratings tend to be chosen by investors and that good ESG rating results represent a relevant and decisive factor when choosing an investment. For this purpose, a narrative literature review was carried out, and the main results were analysed. The results demonstrate that investors are positively influenced by the inclusion of ESG metrics in reported information.

Keywords: Corporate Social Responsibility; Environmental, Social, and Governance; Sustainability Report.

Introduction

Corporate Social Responsibility (CSR) is based on a strategy where significant importance is given to environmental, social, and economic aspects (Elkington, 1997).

CSR is, therefore, playing an increasingly important role in sustainability issues (Altenburger, 2013) where aspects linked to the environment, such as climate change; social aspects, such as social inequality; and economic aspects, such as the scarcity of resources, are particularly important.

CSR performance is now one of the most important investment criteria for stakeholders in the capital market (Sparkes and Cowton, 2004). Thus, the relationship between CSR and company performance deserves further theoretical development.

Arai et al. (2021) highlight in their work an increase of more than 15% in the number of

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sustainable and responsible investments in the period from 2018 to 2020.

To operationalize the communication of CSR strategy and objectives, companies use commercial and sustainability reports to affirm their business models and thus define their responsibility towards stakeholders (Hahn and Kühnen, 2013).

In these reports, how the CSR strategy is communicated is mainly based on the disclosure of ESG criteria, criteria that relate to environmental, social, and governance aspects. However, there is a lack of literature review on ESG analysis (Li et al., 2021).

ESG analyses are based on sustainability assessments and are produced by rating agencies to assess the organization's performance. This evaluation results in ratings, thus forming ESG ratings, which aim to provide useful information to stakeholders (Scalet and Kelly, 2010).

Given the wide range of ESG ratings, stakeholders should be aware of various sources of information to obtain a detailed assessment of a company's CSR policies. Above all, investors should be aware that the various ratings differ in the results obtained based on different priorities and weighting factors (Berg et al., 2019; Billio et al., 2021; Escrig-Olmedo et al., 2019).
In recent years, some studies have emerged analyzing sustainability issues (Miras-Rodríguez et al., 2020; Odriozola and Baraibar-Diez, 2017; Pham and Tran, 2020), and ESG ratings on financial and business performance (Landi and Sciarelli, 2019).

Regarding the impact of sustainability reports on financial and business performance, the literature shows that investors attach increasing importance to these reports in investment decisions (Vitolla et al., 2020; Egginton and McBrayer, 2019; Reverte, 2012). Therefore, there is a positive impact of sustainability reports on the organization's performance.

Concerning ESG ratings, the literature reveals that the main objective is to maximize environmental, social, and governance (ESG) benefits for companies (Ahlström and Monciardini, 2021), thus ensuring access to long-term capital and creating value for all stakeholders (Schoenmaker, 2019).

In parallel with the development of sustainable finance, and because ESG ratings are complex indexes that assess a company's ESG performance (Escrig-Olmedo et al., 2010), rules and regulations have been developed that oblige public interest companies to communicate and disclose non-financial information that relates to their ESG performance (Ahlstrom, 2019; Eccles and Klimenko, 2019; Zadek, 2019).

Through a narrative literature review, and a Scopus search for the most recent articles on ESG disclosure, it will be verified whether the inclusion of ESG assessments in the report has a positive impact from the point of view of investors. In other words, do investors tend to choose companies that demonstrate better ESG results? And whether the fact that companies publish information related to ESG criteria gives them a differential advantage when it comes to investors' investment choices?
This study analyses the relevant theories that underpin the concepts and then subdivides the research into two perspectives: ESG Reporting and ESG Rating.

The results show that the influence of capital invested in companies that report non-financial information has a positive impact on CSR, since, even if the investor has not invested in the ESG factor, their capital will contribute to boosting a company whose policy is already in place and which naturally, and in line with the evolution of legislation, tends to value non-financial parameters more and more.

The analysis of the literature review, therefore, leads us to conclude that investors are positively influenced by the inclusion of ESG metrics in the information reported.

Literature Review

Theoretical Approaches

Shareholder Value Approach & Stakeholder Accountability Approach

The Shareholder Value Approach stresses that the main objective of a company is to maximize the value created for shareholders, investors, and direct participants in the company's capital (Blyth et al., 1986).

As society becomes more aware of environmental problems, companies are forced to face the challenge of meeting the expectations of the various stakeholders, not only in terms of profit but also in terms of the environment and social welfare (Lopes et al., 2023).

The Stakeholder Accountability Approach is a broader approach than the Shareholder Value Approach since it considers all stakeholders, and not just shareholders. The company's economic well-being is considered, but it is not the only objective, as other socially relevant criteria must be considered (Friedmann, 1970; Chen, 1975).

Thus, the challenge for companies is to align organizational culture with strategic decisions to meet the information needs of stakeholders (Ferrell et al., 2010; Freeman and McVea, 2001).

Given the increase in stakeholder concern about CSR policies, we can assume that they are a way of improving management. It is therefore logical that implementing CSR policies in such a way that they have a real impact on the company's strategy represents a relevant part of the theory of responsibility towards all stakeholders (Huijstee and Glasbergen, 2008).

Legitimacy Theory & Signaling Theory

Legitimacy Theory assumes that a company can only exist on the market in the long term if it is legitimized by society (Deegan, 2002).

The concept of legitimacy is based on assessing whether a company's actions and policies correspond to society's values and norms (Suchman et al., 1995).

This theory implies a "social contract" between companies and society, with requirements to be met by the parties (Simoni et al., 2020).

Consequently, beyond what is established by law, the need to identify society's implicit needs is elementary.
In this way, CSR is given a prominent role in achieving or maintaining legitimacy. In this sense, companies should focus on transparently communicating their CSR policies so that their implementation efforts become visible to society and thus contribute to achieving legitimacy (Deegan, 2002).

Integrating ESG ratings into reporting can boost social acceptance, as it serves as proof of the company's internal CSR policies. In this sense, we find a parallel with Signaling Theory.

Signaling Theory translates the position of two parties (the sender of information and the receiver of information) when accessing different information. The sender must choose whether and how to communicate (or signal) the information, and the other party, the receiver, must choose how to interpret the signal (Connelly, et al., 2011).

Through this theory, we believe that companies make information available according to their interests. Thus, organizations with well-developed and implemented internal CSR policies will be more likely to publish ESG ratings to the extent required by law, while companies with "weaker" CSR policies will not provide more than they are effectively obliged to publish by the regulations in force.

According to these theories, sustainability reports and ESG rating results are possible ways of Signaling and maintaining a company's legitimacy by meeting the information needs of all stakeholders.

Agency Theory & Behavioural Agency Theory

Agency Theory highlights the problem of divergence between the interests of the company's shareholders and top managers (Eisenhardt, 1989; Hill and Jones,1992).

The asymmetry of information between the owners of the company and the managers, who work in the company daily and carry out the operations, can lead to the personal interests of the top managers overlapping with those of the shareholders. When this divergence of interests occurs, opportunistic behavior arises (Jensen and Meckling, 1976). To reduce opportunism, two strategies have been adopted. The first involves aligning the financial interests of managers with those of shareholders, for example through the use of stock options or salary increases. The other involves exercising greater control over managers (Liu et al., 2014; Oh et al., 2016).

There is, however, a more recent theory, Behavioural Agency Theory, which proposes that the adoption of non-monetary incentives, such as social, ideological, or psychological incentives, can help mitigate this agency problem (Miller et al., 2014) and reduce opportunistic behavior.

In this way, we assume that CSR represents a behavioral intervention based on agency to reduce opportunism, since managers will be invited to carry out their tasks based on intrinsic motivational policies based on this strategy (Hur et al., 2018; Lu et al.,2020).

Thus, according to McWilliams and Siegel (2001), the adoption of a CSR strategy can help to reduce

agency costs within the organization because the costs associated with operationalizing CSR are offset by reductions in other costs and increases in performance resulting from a reduction in opportunism.
In addition, the consumption of resources caused by policies that corroborate the Agency Theory to reduce agency problems reduces the funds that would otherwise be allocated to profits (Ang et al., 2000; Jensen and Meckling, 1976), and the issue of stock options to align the interests of the company's agents and owners, dilutes the value of the shareholders' investment (Kuo and Yu, 2013).

Corporate Social Responsibility & Environmental, Social and Governance

CSR is defined as a strategy where social and environmental aspects are considered as important as the economic aspect (Elkington 1997, p.2). It can be understood as a set of internal policies that promote strategic orientation within an organization.

According to Wu and Tham (2023), CSR is a powerful tool that serves as a lever for economic growth and quality of life to mitigate externalities and strengthen corporate sustainability.

ESG considerations have become a global issue that is growing in the financial market (Ni and Sun, 2023), both in practice (Friede et al., 2015) and in its dissemination.

In recent years, ESG literature has mainly addressed ESG investing (Daugaard, 2020), and highlights the importance of ESG metrics in SRI (socially responsible investing) (Widyawati, 2020).

However, there are also studies looking at the relationship between corporate governance and corporate social responsibility (Aluchna and Roszkowska-Menkes, 2019), the importance and role of ESG factors in financial economics in the decision-making process (Ziolo et al., 2019), the influence of ESG scores in measuring corporate sustainability performance (Drempetic et al., 2020), and the role and performance of corporate governance in ESG (Yoshikawa et al., 2021).

Substantial changes have taken place over the last two decades, particularly at the government level, to require companies to disclose and communicate more ESG information (Ioannou and Serafeim, 2017).

Stakeholders are also joining this movement, putting pressure on company management in the hope that it will develop a more significant concern for how ESG is disclosed (Babiak and Iova, 2010; Lozano, 2015).

The COVID-19 pandemic has also played a crucial role in raising awareness of ESG disclosure (Adams and Abhayawansa, 2021).

As a result, the quality of ESG reporting is progressively improving these days.

To measure/evaluate environmental, social, and governance issues, ESG ratings have been structured, which are complex evaluation indices that aim to assess the performance of organizations (Escrig-Olmedo et al., 2010) and at the same time create a link between stakeholders and companies (Schäfer, 2005).

Considering the terms ESG and ESG rating as counterparts, we can say that the ESG concept relates to the publication of non-financial information aimed at stakeholders, making known not only the status and results of the CSR strategy but also other types of relevant non-financial information, an example of which is information on cohesion and security in terms of corporate governance.

ESG information is increasingly used in defining the strategy of entities, as well as in the investment decision-making process and the valuation of listed companies (Gawęda, 2021). There is a mutual influence between internal policies (CSR) and the information published in the various reporting media (ESG). In this sense, we can say that companies consider the presence or absence of ESG ratings in their media to be relevant and recognize it as having an impact, which leads us to conclude, based on the Shareholder value approach and the Stakeholder accountability approach, that there is a positive impact on the investment made by stakeholders since this information is published.

ESG Reporting

ESG reporting through sustainability reporting has contributed favorably to corporate well-being and financial performance (Friede et al., 2015). However, the literature has highlighted other merits associated with ESG reporting, namely a lower risk of financial difficulties (Al-Hadi et al., 2019) and faster recovery in the event of financial difficulties (Lin and Dong, 2018).

In addition to financial performance being inseparable from companies' operations, ESG reporting is also considered a "game-changer" in corporate image.

According to Seto-Pamies (2015), the advantages are also detected from the perspective of strategic planning, insofar as reporting impacts the competitiveness of companies and brings some benefits, namely in risk management, cost reduction, access to capital, customer relations, improved human resource management and increased capacity for innovation.

ESG activities and their reporting comprehensively affect the corporation, increasing business competitiveness (Chuang and Huang, 2018; Berry and Rondinelli,1998; Chuang and Huang, 2018), improving corporate image and, cumulatively, increasing the level of stakeholder satisfaction (Brammer and Pavelin, 2008; Xie et al., 2018).

Based on the above statements, we can see that ESG reporting contributes positively to a company's reputation and that reputable companies attract more investment. Thus, we believe that there is evidence in the literature that indicates that investors tend to choose companies that demonstrate better ESG results.

In addition to traditional financial data and complementary data, other information assessed in terms of capital is becoming increasingly important and relevant to investors and is presented in ESG reporting (Foltin and Holtzblatt, 2022). These forms of capital include all forms of company value, human capital, social capital, partnerships, internal research and development, expertise retained by the company, and environmental capital.

Another stream of studies emphasizes the motivation behind ESG reporting. Some studies highlight that one of the reasons for ESG activities (including its reporting) is efficiency in corporate financial conditions (Babiak and Iova, 2010) and to what extent this efficiency results from the company's efforts to optimize its operations and reduce costs (Lozano, 2015).

In short, it is advantageous for companies to report non-financial information in the form of ESG, not least because it has been found that the share price of entities that provide these data is higher compared to those that do not (Banke et al., 2022).

Thus, the evidence shows that reporting non-financial information is extremely relevant considering the positive results it generates for the company financially, in such a way that it influences investors' choices in favor of the company.

ESG Rating

The ESG rating, as mentioned above, consists of a set of complex indices that aim to assess the company's non-financial performance (Escrig-Olmedo et al., 2010). They are, thus, an evaluation system that measures a company's performance concerning environmental, social, and governance criteria.

These criteria provide a framework for assessing the impact of a company's activities on issues such as climate change, sustainability, human rights, diversity, business ethics, and transparency.

The ESG rating creates a link between stakeholders and organizations (Schäfer, 2005).

For investors, ESG ratings provide valuable information about a company's performance in non-financial areas, allowing them to consider these factors when making investment decisions. The importance of these ratings is growing due to the expansion of the securities market and the evolution of ESG reporting standards (Ferri and Liu, 2005). Increasingly conscious investors are looking for companies with high ESG scores, as they believe that sustainable and socially responsible companies are more likely to have solid financial performance in the long term.

In addition, ESG ratings are also useful for company managers. Information from ratings is increasingly used in defining entities' strategies (Gawęda, 2021), in the investment decision-making process, and in the valuation of public limited companies, offering a holistic view of a company's CSR practices and policies, allowing areas for improvement to be identified and targets to be set for improving performance in these areas.

Problems associated with ESG Rating

Metrics and Comparability

There are several problems associated with ESG ratings that affect the purpose of these indicators. One of these problems is the lack of uniformity between the various companies that provide

rating services when it comes to metrics and rating scales.

In general, companies' ESG ratings serve to inform stakeholders and support them in making decisions regarding sustainable financial products (Banke et al., 2022). Although the general aim of ESG ratings is to assess the performance of companies about environmental, social, and governance criteria, the specific metrics and weighting of these factors can differ between different agencies.

Stakeholders should therefore take care to consult a variety of sources to obtain an assertive assessment of CSR policies, as well as their implementation and outcome within a company.

Comparability, especially between sectors of activity, contributes to sustainable development, but we need to understand what we are comparing. Companies with good sustainability performance can obtain advantages and a good rating, thereby sending positive signals to stakeholders (Banke et al., 2022).

Impression Management

Impression Management occurs when management selects the information to be displayed and presents it in a way that aims to distort readers' perceptions of corporate reality (Godfrey et al., 2003; Prakash and Rappaport, 1977).

Merkl-Davies et al. (2011) suggest that managers engage in Impression Management with the expectation that stakeholders will respond in a more desirable way to the corporate behaviors described in companies' narrative documents. These authors also argue that the construction of Impression Management can be carried out by emphasizing positive results (enhancement) and/or overshadowing negative performance (concealment) to present an inaccurate view of organizational results, which contributes to a problem associated with ESG Rating because companies disclose performance that does not correspond to reality.

Management Remuneration

Some companies have adopted the practice of linking management remuneration to ESG rating results as a way of encouraging the adoption of sustainable and responsible practices (Charles et al., 2012). Higher levels of remuneration can drive CEO behavior to be "more tied" to companies, and stakeholders more attentive to social responsibilities (Liu and Zhang, 2017). This means that managers' remuneration can be adjusted based on the company's ESG performance.

Thorne et al. (2017) support that changes in the composition and remuneration mechanisms of managers can be used to influence behavior that is more sensitive to CSR issues, and that reward bonuses can incentivize socially responsible actions.

It is important to note that remuneration practices linked to ESG ratings can vary widely between companies and sectors, as companies develop a more sophisticated understanding of ESG and seek to align their remuneration practices with their sustainability objectives.

ESG Disconnect

Green business strategies are often adopted to embrace a green organizational identity and raise awareness of the complex concept of corporate sustainability (Przychodzen and Przychodzen, 2018). The problem related to the concept of ESG disconnect relates to the fact that the majority of newly patented green technologies are not driven by companies with high ESG ratings, but rather by companies that are excluded from the investment universe of ESG funds (Cohen et al., 2021).

There is thus a "disconnect" between the results of the ESG assessment and the practical development of activities by some companies.

Mitigating Information Asymmetry

Greiner and Sun (2021) argue that the implementation of CSR policies represents an intervention from the perspective of Behavioural Agency Theory to reduce opportunism and promote intrinsic motivation among managers. Other studies prove the ability of CSR policies to motivate managers and reduce opportunism (Hur et al., 2018; Lu et al., 2020).

The publication through ESG ratings of the results of the adoption of CSR policies within the company also has a positive impact in terms of combating problems of information asymmetry, as it enables all stakeholders to be reached.

Disclosure and Transparency

There are some problems associated with the form and substance of ESG ratings in that it has been found that they do not allow principles such as comparability in disclosure and transparency to be respected.

Some initiatives have been working to create more consistent standards and metrics capable

of eliminating these problems, such as the GRI (Global Reporting Initiative), the IIRC (International Integrated Reporting Council), and, in the future, the ESRS (European Sustainability Reporting Standards) in a partnership between EFRAG (European Financial Reporting Advisory Group) and the GRI (Buchholz et al., 2020).

It is also necessary to maximize the usefulness for all stakeholders and not just investors, and this is possible by orienting towards the SDGs when preparing non-financial information through ESG ratings, in that emphasis should be placed on ESG ratings that show a higher correlation with certain SDGs.

Conclusion

Companies are increasingly led to address sustainability issues in their business models and reports, and when reporting legally required information, to meet the ESG information needs of stakeholders, a situation which is in line with the Stakeholder Accountability Approach.

Through the Signaling Theory, it can be said that companies make information available according to their interests. Thus, organizations with well-developed and implemented internal CSR policies will be more likely to publish ESG ratings to the extent required by law.

The results of this work show that the influence of capital invested in companies that report non-financial information has a positive impact on CSR, since, even if the investor hasn't invested for the ESG factor, their capital will contribute to boosting a company whose policy is already in place and which naturally, and in line with the evolution of legislation, tends to value non-financial parameters more and more.

This study concludes that investors tend to choose companies that demonstrate better ESG results, and companies that publish information related to ESG criteria have a differential advantage when it comes to investors' investment choices.

The study contributes to investors, making them aware of the need for a more detailed analysis of disclosure, since the biggest problems associated with ESG reporting are highlighted.

Considering the limitations of this work, it is considered pertinent to carry out a study of the capital market, to assess whether the results are confirmed.

This work also reveals key elements that should be combined when producing non-financial information, such as sensory marketing (Gómez Suárez,2012; Wright et al., 2006), not to positively bias stakeholders' opinions, but to facilitate information analysis, thus contributing to reports that are more accessible to analyse. This is certainly also a line of future research to be considered.

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