

Relationship between Environmental, Social and Governance Factors and Firm Financial Performance: A Study of Selected Indian FMCG Companies

¹*Neerja Agarwal, Prakash Rao, ²Jeevan Nagarkar

^{1,2}Symbiosis Institute of International Business, Symbiosis International (Deemed University), Pune, Maharashtra, India

*Corresponding author:
dydirector@siib.ac.in

Abstract

The nature of the corporate environment requires a variety of practices to achieve competitive benefits. Environment, Social, and Governance (ESG) performance of an organization is considered a key indicator for sustainable and long-term returns. Investors are increasingly looking into the ESG practices of companies while making their investment decisions, and companies are seeking new ways to showcase their ESG prowess to investors. Showcasing the ESG performance helps the companies to build the brand reputation. The market valuation of such companies can also increase with the rise in PE Ratio as the investor perception increases. The paper evaluates the connection between the ESG factors and economic factors of the top five FMCG firms based on their market capitalization. Regression models have been utilized to measure and establish the relationship between both factors. The research results show that improved ESG implementation helps increase the overall economic value of the organizations. The sub-factors E, S, and G show a positive relationship with the economic performance, which clearly outlines why the FMCG companies are now taking various environmental and social initiatives.

Keywords

ESG Performance, Corporate financial Performance, Sustainability, FMCG companies, financial ratios, ESG Ratings

Imprint

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1. Introduction

Business organizations worldwide are now shifting from increasing profits to aligning the company's goals to the ESG objectives to become sustainable in the end, which is the growing understanding that the ESG aspects can become a big threat for the businesses in the future and can affect the overall economic returns and brand image of the organizations. Client demand from both retail and institutional stakeholders has increased [1]. It is the top reason reported by executives to incorporate ESG factors into investment decisions. ESG has become a very significant measure for capital markets, as organizations with high ESG values have demonstrated to reduce risks, better yields, and are stronger amid an emergency. Many investors have started adopting ESG investment strategies to think about the firm suitable for investing. Organizations with ESG plans are thought to have a more long-term, sustainable perspective than non-ESG companies, allowing them to outperform organizations without ESG plans [2]. It has become an important aspect for the various stakeholders to account for to make their operations profitable. Therefore, organizations' ESG disclosures have significantly increased to fulfill the stakeholder's demands.

Therefore, studying more on the ESG performance of the sector becomes more important and relevant to attract more and more investors. Responsible corporate approaches consider ESG components to manage the risk efficiently and produce long-term profits for the stakeholders. In recent years, environmental and social issues have become increasingly important in society. Today, many consumers choose to shop for environmentally friendly products, although costlier than "traditional" products. Similarly, an increasing number of investors seek financially viable and socially sustainable companies in the end. Many finance providers increasingly use ESG factors as a criterion for making investment decisions, including the environmental, social, and corporate governance strategies and practices into an organization's policies [3]. The majority of the stakeholders views its everyday processes very extensively. These policies display the firm's ability to continue working sustainably and adopting a holistic approach to achieve long-term objectives. Only those corporations can survive in the end, considering and incorporating necessary steps to-

wards the changing requirements of their partners, local communities, and the overall working conditions. Companies also benefit from ESG reporting because evaluating their ESG strategy and their “sustainability” depends on how this information is communicated to investors and other financial experts. This study attempts to provide information by evaluating ESG and the economic performance of businesses and drawing a link between the two.

2. Literature Review

Various studies and research have been carried out to show the relationship between the ESG indicators and the subfactors and the overall economic performance of any company; principles for Responsible Investment (PRI) establish a prominent link between ESG and economic performance, according to Cek and Eyupoglu. Few analyses from all over the globe have observed the linkages and dependencies between the ESG values and financial returns. However, in India, not much research is carried out on this front.

There is an established link between pollution (environmental indicator) and the financial performance of companies, as stated by Bragdon. The majority economic view suggested that a company concerned about pollution issues could not be profitable simultaneously, which shows a negative relationship between the factors. Another study found that the larger a firm is, the more effort it puts into environmental, social, and governance (ESG) issues, as observed by Parket and Gilbert. As a result, large corporations have an edge in ESG strategy. As a result, a plethora of academic research has been conducted, each yielding diverse outcomes [4]. Almost all published studies and researches on the subject agree that ESG indicators have a non-negative impact on financial metrics. In addition, reviews were conducted to focus more on the precise relationships amid ESG and commercial production:

- **Impacts of ESG on Economic performance:** The impacts of ESG have perpetually been a significant study topic over the years. There have been many studies about how the ESG performance affects the firm's financials, be it positive, negative, or neutral, as researched by Ramic. Putting resources in setting up proper environmental, social, and governance objectives of any company can always help improve the company's brand image and reputation, as studied by Godfrey, Merrill, and Han-

sen. Several researches were conducted by Gunnar Friede, Timo Busch, and Bassen comparing ESG performance with company financial performance. According to the findings, there is a direct bond amid ESG and commercial success aspects, as recorded by Friede. Abbott and Monsen conducted research and discovered that Environment, social, and governance (ESG) production had little bearing on commercial production, according to Abbott and Monsen. Similarly, the connection amid collective group duty and commercial production can be contradictory, implying a strong negative association between the two, as stated by Vance.

- **Effect of sub-factor Environment, Social, and Governance on commercial production:** The overall ESG score of any organization is based on the individual scores of the sub-factors, i.e., environmental, social, and governance. The effect of the environmental score on the valuation of any company is always looked after because the investors consider this as a very important parameter before investing in any organization. Valuable insights have been obtained on the opinions for the impacts of good environmental performance on the market value of any company, as observed by McGuire, Sundgren, and Schneeweis. Various other theories highlight that the costs incurred to improve the environmental performance can generate other benefits, such as increased efficiency of production, which leads to more profits, as researched by Russo, and Fouts [5].

Because workers are one of the most important collections of participants in any company, how the firm manages its interactions with them can affect its overall financial performance, as recorded by Delery and Doty. The study of Friede *et al.*, according to Friede, clearly shows that the subfactor social has no relation between ESG factors and financial factors. The social performance of companies dealing with basic amenities and services positively influences financial performance, as stated by Daszyńska-Żygadło. Customers play a significant role in improving the finances of any company because their insights can be used to improve the product's quality, which in turn improves the overall finances, as observed by Waddock and Graves.

The governance factor shows both positive and negative relations. Major literature studies show that the impact of corporate governance on economic per-

formance is concentrating either on variations due to different policies of the company or differences in the overall governance structure between the companies. It has also been noticed that obligatory corporate governance policies and strategies could lead to the growth of companies in India in terms of market value, as researched by Black and Khanna. The governance of any firm also supports its ability to focus on the issues of the local communities and provide resolutions, which offer the durable commercial performance of the organizations, as researched by Yoon, Lee, and Byun [6].

There are several reasons why studies on the relationship between financial performance and ESG lead to different conclusions. According to Trivedi, there are two main categories of indicators to measure the financial performance of any firm: accounting indicators and stock market indicators. On the contrary, ESG performance of companies in a wide notion that involves a multitude of indicators leads to a multitude of different results.

3. Objectives

The study had the following objectives:

- To analyze the relationship amid the ESG scores and commercial production of the considered FMCG companies.
- To study the impact of the subfactors Environment (E), Social (S), and Governance (G) on the financial performance of the considered FMCG companies [7].

4. Hypothesis

A hypothesis study is to be conducted through secondary data research to collect the data variables as required. Five hypotheses are tested under this research.

Hypothesis 1

Ho = Relationship between ESG factor and accounting indicator of the considered FMCG companies is positive.

Ha = relationship between the ESG factor and accounting indicator of the considered FMCG companies is not positive.

Hypothesis 2

Ho = Connection amid the ESG factor and stock exchange indicator of the considered FMCG companies is positive.

Ha = Connection amid the ESG factor and stock exchange indicator of the considered FMCG companies is not positive.

Hypothesis 3

Ho = Impact of the subfactor Environment (E) on the financial performance of the considered FMCG companies is positive.

Ha = Impact of the subfactor Environment (E) on the financial performance of the considered FMCG companies is not positive.

Hypothesis 4

Ho = impact of the subfactor Social (S) on the commercial production of the considered FMCG corporations is positive.

Ha = impact of the subfactor Social (S) on the commercial production of the considered FMCG corporations is not positive.

Hypothesis 5

Ho = Impact of the subfactor Governance (G) on the commercial production of the considered FMCG corporations is positive.

Ha = Impact of the subfactor Governance (G) on the commercial production of the considered FMCG corporations is not positive.

5. Methodology

The research aims to illustrate how the ESG performance affects the commercial production of the considered FMCG Corporations of India. The methodology that will be used to analyze the data is regression models and equations. There are two main categories of indicators of a company's financial performance: accounting and stock market indicators. We will be using the Return on Capital Employed (ROCE) and stock market indicator for the accounting indicator; we will be using Tobin's Q Ratio [8]. The instrument applied to investigate and evaluate outcomes is SPSS 25.0 Software. Data is considered for the financial year 2019.

FMCG Companies

Five FMCG companies were studied for analysis based on market capitalization. The companies were:

1. Hindustan Unilever Ltd. (HUL)
2. ITC Ltd
3. Dabur India Ltd.

4. Marico
5. Colgate Palmolive Ltd.

The ESG and financial data for the companies listed in Table 1 were collected via secondary research, including audited annual and final reports of the companies available in the public domain apart from Internet-based platforms like www.in.finance.yahoo.com and www.moneycontrol.com

Data Variables

The investigation was conducted applying the below-mentioned information variables:

Financial Factors:

1. Return on Capital Employed (ROCE) - It is the rate of a business's income (profits earlier to interest and taxes) to the entire capital invested in the company. The ROCE value will be utilized as the accounting indicator to examine the influence of ESG issues on financial performance. It will be used as a subordinate variable in the regression model.
2. Tobin's Q Ratio is the proportion of its overall market value to its total asset value. Tobin's Q Ratio

will be utilized as the stock market indicator to examine the influence of ESG issues on commercial production. It will be used as a secondary variable in the regression model.

3. Debt to Equity Ratio - It is the ratio of its total liabilities to its total shareholders' equity. This parameter harms the overall economic performance as companies with fewer debts have a strong financial performance. It is a proportion of how much an organization is financing its activities through debts versus reserves. In the regression model, it will be used as a control variable.
4. The logarithm of the firm's total assets (Log TA) is used to reference the company's size. In the regression model, it will be used as a control variable.

ESG Factor:

5. ESG Scores - In the regression model, the environmental, social, and governance (ESG) score of a company will be used as the independent variables in Table 2.

Table 1

Financial Data of the considered companies

#	FMCG Companies	ROCE Value	Tobin's Q Ratio	D/E Ratio	Total assets (TA) (in Cr)	Log TA
1	Hindustan Unilever Ltd. (HUL)	0.9227	8.74	0.01	17,865.00	11.252
2	ITC Limited	0.3007	5.52	0.0001	69,797.92	11.843
3	Dabur India Ltd.	0.3775	8.34	0.09	5,578.78	10.746
4	Marico	0.3409	5.71	0.05	4,641.00	10.666
5	Colgate Palmolive Ltd.	0.7074	11.21	0.02	2,626.48	10.419

Sources:

ROCE Value - (Money Control, n.d.)

Tobin's Q Ratio - (Saji & Eldhose K.V, 2017)

D/E Ratio - (Money Control, n.d.)

Total Assets - (Money Control, n.d.)

Table 2

ESG Scores of the considered companies

#	FMCG Companies	ESG Score	Environmental Score	Social Score	Governance Score
1	Hindustan Unilever Ltd. (HUL)	26	11.3	7.9	6.7
2	ITC Limited	27	6.8	12.1	8.4
3	Dabur India Ltd.	30	12.4	8.5	8.6
4	Marico	26	10.2	6.8	8.7
5	Colgate Palmolive Ltd.	22	6.7	8.9	6.2

Sources:

ESG Scores - (Yahoo Finance, n.d.)

6. Results and Discussions

Relationship between ESG score and Financial Performance –

Under this, we carried out separated regressions for the accounting indicators and stock market indicators.

6.1. Relationship between ESG score and Accounting Indicators (Hypothesis 1)

The accounting indicator is the Return on Capital Employed (ROCE). In the regression model, the ROCE value is the dependent variable, and ESG rating is the independent variable in Table 3. The other variables are Debt-to-Equity Ratio and Log of Total Assets (LogTA).

Ho's hypothesis is accepted because the significant value is higher than 0.05, which indicates that the ESG component and the accounting indication of the FMCG companies under consideration have a favorable association, which demonstrates the importance of ESG scores for a company's growth and expansion [9].

Table 3

Coefficients when the dependent variable is ROCE

Coefficients								
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	95% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	19.201	7.612		2.522	0.240	-77.520	115.923
	ESG	0.521	0.243	5.468	2.145	0.278	-2.562	3.604
	DE	-51.186	21.642	-6.843	-2.365	0.255	-326.179	223.808
	LogTA	-2.783	1.192	-5.789	-2.335	0.258	-17.923	12.358
a. Dependent Variable: ROCE								

Table 4

Model Summary when the dependent variable is ROCE

Model Summary				
Model	R	R square	Adjusted R Square	Std. The error of the Estimate
1	0.941	0.886	0.543	0.1843620
a. Predictors: (Constant), LogTA, ESG, DE				

Table 5

Coefficients when the dependent variable is Tobin's Q Ratio

Coefficients								
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	95% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	88.885	134.393		.661	0.628	-1618.746	1796.516
	ESG	1.401	4.284	1.698	.327	0.799	-53.031	55.832
	DE	-152.914	382.101	-2.360	-.400	0.758	-5007.969	4702.141
	LogTA	-10.239	21.038	-2.459	-.487	0.712	-277.551	257.073
a. Dependent Variable: TobinsQ								

The regression equation thus formed is –

$$ROCE = 19.201 + 0.521ESG - 51.186DE - 2.783Log TA$$

This equation also shows that ROCE is positively related to the ESG score.

The high value of R suggests a highly positive correlation between the ROCE value and ESG scores. The value of R square suggests that the independent variable ROCE represents a good proportion of the variance for the dependent variable. However, further research can be done with a greater sample to test this hypothesis [10]. Table 4 shows the model summary in ROCE.

6.2. Relationship between ESG score and Stock Market Indicators (Hypothesis 2)

Table 5 shows the stock market indicator is Tobin's Q Ratio value. Tobin's Q Ratio value is the dependent variable, and ESG rating is the independent variable in the

regression model. The other variables are Debt-to-Equity Ratio and Log of Total Assets (Log TA).

Since the significant value, in this case, is also greater than 0.05; therefore, the hypothesis, H_0 is received, indicates an actual relationship between the ESG factor and stock market indicator, which clearly shows that investors consider ESG scores of the firms before investing [11].

The regression equation thus formed is –

$$\text{Tobin's Q} = 88.885 + 1.401\text{ESG} - 152.914\text{DE} - 10.239\text{LogTA}$$

This equation also shows that Tobin's Q value is positively linked to the overall ESG score.

Table 6 shows the high value of R suggests a high actual correlation amid Tobin's Q value and ESG scores. The value of R square suggests that the independent variable Tobin's Q ratio represents a very normal proportion of the variance for the dependent variable. However, further research can be done with a large sample size to test this hypothesis [12].

From both these regression models, we can say that ESG scores have a high positive connection with the company's financial achievement.

Connection amid subfactor Environment, Social and Governance, and Financial Performance –

Under this, we carried out separated regressions for the subfactors E, S, and G and both the financial indicators [13].

6.3. Relationship between subfactor E and financial performance (Hypothesis 3)

In the regression model, the subfactor E, i.e., environment is the independent variable. At the same time, the financial performance indicators (ROCE and Tobin's Q Ratio) are the dependent variables. The other variables are Debt-to-Equity Ratio and Log of Total Assets (Log TA) [14]. Table 7 shows the dependent variable is ROCE.

Since the significant value in both cases is greater than 0.05, therefore, the hypothesis, H_0 is accepted, which means that the subfactor E, Environment shows a positive relationship with the financial performance indicators, which signifies that investor engage more in environmentally responsible organizations, which is one of the reasons as to why the FMCG companies have started taking various environmental initiatives [15]. Table 8 shows the dependent variable is Tobin's Q Ratio.

6.4. Relationship between sub factor S and financial performance (Hypothesis 4)

In the regression model, the subfactor S, i.e., social, is the independent variable. At the same time, the financial performance indicators (ROCE and Tobin's Q Ratio) are the dependent variables. The other variables are Debt-to-Equity Ratio and Log of Total Assets (Log TA) [16]. Table 9 shows the coefficients when the dependent variable is ROCE.

Table 6

Model Summary when the dependent variable is Tobin's Q Ratio

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.725a	0.525	-0.899	3.2549411
a. Predictors: (Constant), Log TA, ESG, DE				

Table 7

Coefficients when the dependent variable is ROCE

Coefficients								
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	95% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	4.189	2.935		1.427	0.389	-33.110	41.488
	E	0.100	0.067	.961	1.497	0.375	-0.751	0.952
	DETECTORS/DETECTION	-11.223	5.668	-1.500	-1.980	0.298	-83.240	60.794
	LogTA	-0.385	0.270	-.801	-1.424	0.390	-3.819	3.049
a. Dependent Variable: ROCE								

Table 8

Coefficients when the dependent variable is Tobin's Q Ratio

Coefficients								
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	95% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	47.781	40.921		1.168	0.451	-472.172	567.734
	E	0.154	0.934	0.170	0.165	0.896	-11.717	12.025
	DE	-38.440	79.011	-0.593	-0.487	0.712	-1042.373	965.493
	LogTA	-3.644	3.768	-0.875	-0.967	0.511	-51.520	44.232
a. Dependent Variable: TobinsQ								

Table 9

Coefficients when the dependent variable is ROCE

Coefficients								
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	95% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	2.382	5.156		0.462	0.724	-63.130	67.894
	S	-.074	.141	-.543	-0.526	0.692	-1.872	1.723
	DE	-5.712	6.449	-.764	-0.886	0.539	-87.648	76.224
	LogTA	-.091	.522	-.189	-0.174	0.890	-6.723	6.541
a. Dependent Variable: ROCE								

Since the significant value in both cases is greater than 0.05, therefore, the hypothesis, H_0 is admitted, which indicates that the subfactor S, Social, shows a positive relationship with the financial performance indicators, which signifies that nowadays the stakeholders also consider the social initiatives and CSR activities, which the organizations do before investing. Table 10 shows in coefficient when the dependent variable is Tobin's Q Ratio.

6.5. Relationship between sub factor G and financial performance (Hypothesis 5)

Table 11 shown in the regression model, the subfactor G, i.e., governance is the independent variable.

At the same time, the financial performance indicators (ROCE and Tobin's Q Ratio) are the dependent variables. The other variables are Debt-to-Equity Ratio and Log of Total Assets (Log TA).

Since the significant value in both cases is greater than 0.05, therefore, the hypothesis, H_0 is admitted, which indicates that the subfactor G, Governance shows a definite connection with the commercial production indicators, which justifies the reasons as to why companies are becoming more transparent in providing information about the governance structure [17]. Table 12 shows the dependent variables.

Table 10

Coefficients when the dependent variable is Tobin's Q Ratio

Coefficients								
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	95% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	53.433	43.188		1.237	0.433	-495.322	602.188
	S	.412	1.185	.346	0.347	0.787	-14.647	15.470
	DE	-26.493	54.015	-.409	-0.490	0.710	-712.823	659.837
	LogTA	-4.394	4.372	-1.055	-1.005	0.498	-59.947	51.160
a. Dependent Variable: TobinsQ								

Table 11

Coefficients when the dependent variable is ROCE

Coefficients								
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	95% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	.587	3.079		.191	0.880	-38.538	39.711
	G	-0.278	.157	-1.201	-1.769	0.328	-2.275	1.719
	DE	3.197	5.933	0.427	.539	0.685	-72.188	78.582
	LogTA	0.180	.338	00.375	.534	0.688	-4.113	4.474
a. Dependent Variable: ROCE								

Table 12

Coefficients when the dependent variable is Tobin's Q Ratio

Coefficients								
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	95% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	21.142	14.709		1.437	0.387	-165.751	208.034
	G	-2.392	0.751	-1.193	-3.186	0.194	-11.932	7.148
	DE	43.142	28.341	0.666	1.522	0.370	-316.959	403.243
	LogTA	0.342	1.614	0.082	0.212	0.867	-20.167	20.852
a. Dependent Variable: TobinsQ								

From all these regression models, we can say that the subfactors Environment, Social, and Governance have a high positive relationship with the overall economic performance of the company [18].

7. Conclusion

Environment, Social, and Governance (ESG) performance of an organization is considered one of the key indicators for sustainable and long-term returns. Investors are increasingly looking into the ESG practices of companies while making their investment decisions. The study establishes a definite connection amid the ESG production and commercial production of the FMCG companies under consideration, which means that by improving the ESG scores of the firm, the economic performance will also enhance because nowadays, the investors and different other stakeholders also take into account the overall ESG initiatives of the companies before investing.

Improved ESG scores will also help the investors identify the organizations that can have good financial returns in the end due to early identification and reduction in the overall ESG risks. The study also highlights that the subfactors E, S, and G also share a positive relationship with the overall economic perfor-

mance of the companies. Companies have also started ESG reporting, which will showcase the in-depth targets and achievements in the ESG field.

8. Limitations

One of the main restrictions of this research is inadequate information access. The scope of the study was limited to only five FMCG companies. Another major constraint is the minor analysis conducted in ESG performance and its impact on the financial performance of the FMCG companies, which may have inflicted restrictions on the overall results. It is suggested that the research scope can be increased by considering many companies for the analysis and better results in the future.

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