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Study on the impact of ESG governance on enterprise performance —— Take China Company A as an example

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Keywords

ESG governance; enterprise performance

Abstract

With the deepening of the concept of sustainable development, the environment, society and corporate governance (ESG) has gradually become a topic of close attention to policy makers, regulators, enterprises, investors and other stakeholders. In 2019, the Hong Kong Stock Exchange's newly revised Environmental, Social and Governance Reporting Guidelines added the mandatory disclosure requirement of the board of Directors, emphasizing for the first time that ESG reporting issuers should integrate ESG into the governance level, marking the beginning of the focus of market regulation from "reporting" to "management". In this paper, company A serves as A research case, selects the relevant data of A company from 2018 to 2022, analyzes the current situation of ESG information disclosure, and studies the impact of ESG performance on enterprise performance, so as to provide suggestions for relevant enterprises in the same industry to improve ESG information disclosure.

Introduction

The impact of COVID-19 has sounded an alarm to the global economy: pandemics, climate change and other systemic risks should also be important factors that cannot be ignored on the road to social and economic development. In formulating post-pandemic recovery plans, countries have begun to emphasize the goals and issues such as sustainability and green as important considerations for economic stimulus policies. This also increases the corporate environment, society and governance (ESG) Ma Wenchao, 2018. Since the double carbon target, enterprises have gradually incorporated ESG rating standards into the development path. ESG is an indicator and evaluation standard to measure the sustainability ability of brands. The textile and clothing industry will promote the construction of ESG and advocate the concept of low-carbon environmental protection development, which is of great significance for the industry to eliminate backward production capacity, promote industrial transformation and upgrading, and realize high-quality and sustainable development. This requires enterprises to establish a good image of corporate citizen externally Li Wei'an, 2019）; maintain high sensitivity to external environment changes internally, and pay more attention to non-financial indicators.

According to the data of the Blue Book of Environment, Society and Governance of Chinese Listed Companies (ESG), the ESG risk of Listed companies in China is generally high, among which the textile and garment industry is a high ESG risk industry, and ESG management and risk prevention need to be improved urgently. In this study, taking company A as the research case, select the relevant data of Company A from 2018 to 2022, analyze the current situation of ESG information disclosure, study the impact of company A ESG performance on enterprise performance, and provide suggestions for relevant enterprises in the same industry to improve ESG information disclosure.

A Effectiveness analysis of the company's ESG governance

Overall performance

According to Shanghai China index information service company on April 30,2023 the stock of ESG rating data, A company ESG grade rating grade, in GICS tertiary industry 120 textile and garment enterprises ranked 12th, only 7.5% of tertiary industry rating for BBB is better than A company, thus the overall performance of A company ESG governance in the industry leading level. Table 1 reflects the specific scores and rating changes of Company A ESG in the three dimensions from 2018 to 2022.

Table 1 A Company ESG score data

Dimension	General disclosure level	2018	2019	2020	2021	2022
Environment	E. Environmental management system	52.24	70	60	60	60
	E External environment certification	20	20	20	20	25
	E green business objectives	52	50.56	50.56	50.56	50.56
	E green product	75.3	73.42	73.42	73.42	75.3
	E. Environmental violations	100	100	100	100	100
	E grade	CC	CC	CC	CC	CC
Society	S system	70	70	70	70	70
	S Health and Safety	93.73	87.05	87.05	87.05	93.73
	S Social contribution	66.67	88.12	71.88	55.64	54.53
	S quality control	58.89	60	60	60	63
	S grade	A	BBB	BB	B	BBB
Administer	G institutional improvement	60	60	70	70	70
	G managerial hierarchy	70	70	70	70	70
	G operating activities	80	70	70	70	70
	G operational risk	88	88	85	85	85
	G external punishment	100	100	100	100	100
	G grade	BB	BBB	BBB	BBB	BBB
A ESG overall rating		BB	BB	BB	B	BB
A ESG overall score		79.41	77.68	76.49	74.71	75.50

(Data source: CSI ESG rating)

From the perspective of governance dimension, Youngor's score in governance structure and external punishment in recent years is relatively stable, and the score of system construction shows an upward trend, but the score of operational risk shows a downward trend. In general, the external punishments had the highest score at this level, at 100 points, while the other disclosure levels remained at 70-85 points, at the upper middle level.

Impact of ESG governance on Company A's performance

Profitability

Table 2 shows that return on equity (impairment) fluctuates slightly between 11% and 14%, but has been rising overall, with return on assets of 5% to 10%. There was a slight upward trend in the 6% range. There is a gap between the change trends and the ESG scores. However, when we look at quality indicators of company profitability, sales cash flow and sales have consistently declined over the past five years, almost consistent with the changes in ESG scores over the past few years. In this way, ESG scores can more objectively reflect the quality of the company's profitability, preventing the adjustment of profitability indicators through earnings management, thus distorting financial information.

Table 2 A. Changes in the company's profitability

Year	All capital earnings rate (weighting)	Return on equity (Button non)	Sales net cash flow / revenue	Operating cash flow / revenue
2018	5.16	11.79	1.44	0.28
2019	5.06	12.78	1.35	0.22
2020	8.97	11.31	1.45	0.19
2021	6.41	14.18	0.87	0.08
2022	6.41	13.08	0.68	-0.13

(Data source: Oriental Fortune)

Growth ability

Table 3 reflects the changes in the growth ability of Company A. Operating income is increasing, but very unstable and unstable. The volatility in year-on-year net profit growth was also clear: it was unusually high in 2018 and negative in 2021. The year-on-year growth rate of total assets continued to decline, and asset investment continued to shrink in 2022. This indicates that the market demand for Company A is unstable, and the growth of operating income and net income is unstable and sustainable. As companies further reduce asset investment from the perspective of risk avoidance and implement conservative investment strategies to slow down the pace of corporate expansion, it can be seen that the change in the total asset growth rate in the past few years is roughly the same as the change in ESG scores. In this way, the ESG score partly reflects the company's growth potential, without misleading investors into the illusion of profit management prosperity.

Table 3 A Changes in the growth ability of companies

Year	Year-on-year growth rate of total assets	Year-on-year growth rate of operating revenue	Net profit year-on-year growth rate
2018	12.22	-2.07	1151.02
2019	6.68	28.91	7.45
2020	-0.8	-7.61	82.37
2021	0.26	18.57	-28.74
2022	-3.05	8.92	-1.37

(Data source: Oriental Fortune)

Debt paying ability

Table 3 reflects the A company solvency changes, debt and interest-bearing capital ratio is leveraged, the main reason is insufficient financing, especially the market demand for interest-bearing debt is unstable, sales and net income volatility, lack of confidence in the future development, they do not have the courage to increase the scale of interest-bearing debt. By 2022, it will be below its 2018 levels. This shows that during the economic downturn, companies are working to reduce the holding of tangible capital and improve the efficiency of capital use by accelerating inventory turnover and accounts receivable turnover. However, in 2020, due to the spread of infection, the decline speed of enterprise inventory and accounts receivable decreased, and the interest-free operating debt such as accounts payable generated by procurement activities decreased rapidly, resulting in an increase in the flow ratio and flow velocity ratio.

Table 3 A. Changes in the solvency of the Company

Year	Asset-liability ratio	Current ratio	Quick ratio	Interest-rate debt / total invested capital (%)
2018	62.46	1.09	0.62	53.41
2019	65.28	0.76	0.44	53.72
2020	64.12	0.98	0.65	47.76
2021	57.41	0.94	0.53	40.68
2022	51.00	1.07	0.54	38.80

(Data source: Oriental Fortune)

The increasing uncertainty of the macroeconomic environment makes enterprises more conservative in financing strategies, and reduce financing costs and repayment risks as far as possible. Overall, changes in ESG scores were similar to changes in the debt-to-asset ratio in capital and capital adequacy ratios. The correlation between the changes in corporate financing strategy is very obvious.

Operating capacity

Table 4 reflects the changes in the operating capacity of Company A, with the inventory turnover ratio and the total asset turnover rate rising slightly, and the receivables turnover rate rising significantly. However, with continued decline, cash flow of operating activities to total assets over the past five years and will be negative by 2022. In this way, although the turnover rate of enterprise inventory and total assets is accelerating, the cash flow of business activities in the turnover rate of tangible assets is decreasing, which reflects the poor quality of tangible assets to some extent.

Table 4 A. Changes in the operating capacity of the Company

Year	Inventory turnover ratio	Average accounts receivable turnover ratio	Turnover of total capital	Net cash flow / operating activities of total assets (%)
2018	0.34	27.77	0.14	3.60%
2019	0.36	32.06	0.16	3.43%
2020	0.33	28.89	0.14	2.76%
2021	0.36	38.17	0.17	1.32%
2022	0.40	51.54	0.19	-2.49%

(Data source: Oriental Fortune)

Conclusion

In this paper, ESG disclosure information from 2018 to 2022 is taken as the research object to analyze the relationship between ESG information disclosure and financial indicators, and further study the impact of ESG information disclosure on enterprise performance.

The research shows that: 1) The better the enterprise ESG information disclosure, the more significant the improvement of enterprise performance. The strengthening of ESG information disclosure not only means the responsibility of enterprises in the three dimensions of environment, society and governance, but also means that more stakeholders will pay attention to the development of enterprises, improve reputation capital, strengthen external supervision, and then optimize the allocation efficiency of social resources.

2）The ESG score has a certain prediction effect on the change of enterprise market value. ESG score can keenly reflect the change of Tobin Q value in the later period one year in advance. The growth of ESG score is conducive to investors to make judgment on the enterprise value in the later stage, transmit the signal of good enterprise performance, and enhance investor confidence.

3) ESG score can deeply reflect the real financial situation and profit quality of an enterprise, and is more sensitive than ROE and other indicators highly concerned by investors. It can help the management of a company strengthen the identification and prevention of financial risks, improve corporate governance ability, and improve enterprise performance.

It should be noted that ESG governance is not a channel of influence for individual companies, but is closely related and complementary. For example, reducing corporate ESG risk and improving the transparency of information disclosure will lead to more financing channels, thus easing funding constraints. In addition, the expansion of capital channels will promote technological innovation and improve the competitiveness of enterprises. This will lead to an increase in profitability, which will also lead to a reduction of corporate risk.

Suggestion

According to the above analysis, as the ESG system in China is still in its infancy, the ESG governance of listed companies in China's textile and garment industry includes the lack of board of directors management, the separation of management performance evaluation and ESG management, and the development of ESG information, etc. As a leading company in the textile and apparel industry and a pioneer in ESG governance, the company will set a good example for other companies in the industry. This paper summarizes the scientific efforts of Company A in ESG governance and presents the following points from both corporate and government perspectives to promote ESG governance throughout the industry.

Build an enterprise ESG governance framework

Good governance structure is the premise of the healthy development of enterprises. The stock exchange emphasizes board participation because the internal implementation of the ESG concept requires the power of an organization rather than one person. By thoroughly reforming the organizational framework and integrating the ESG concept, and establishing a top-down organic framework, each ESG goal can be achieved. The board of directors needs to develop sustainable growth strategies, and set clear ESG performance targets, and then the front-line operations department needs to execute instructions.

Therefore, companies need to establish governance to manage ESG affairs. At the board level, we will set up ESG special committees, such as ESG Committee and Sustainable Development Committee, to make comprehensive decisions and audit ESG related matters. If necessary, the ESG executive management department shall be established under the technical Committee of the Board of Directors to decompose and promote the ESG objectives set by the Board of Directors in detail. In addition, we have established three ESG working groups at the business level, each responsible for operations related to environmental, social and corporate governance. By covering the features required by ESG, it will be more flexibility to execute business and improve efficiency.

Link the ESG governance performance to the employee performance

By integrating ESG performance into company performance management, rewarding and punishing employees can increase their motivation to participate in ESG activities, so as to avoid employees being perfunctory to ESG work and efficiently carry out high-quality ESG activities. However, ESG performance management is not a simple definition; it needs a scientific and reasonable evaluation system.

First of all, in the selection of evaluation indicators must be clear, and consistent with the job responsibilities. Performance evaluation is a long-term management activity that improves the quality of work by observing the scores of various indicators, clarifying the problems faced by employees in ESG work, and clarifying the direction of future initiatives. Second, by incorporating the stakeholder expectations of each into the evaluation system, companies can be operated while considering each stakeholder needs. ESG performance evaluation can allow employees to have a more specific understanding of ESG, rather than a philosophical view, and can also help to form the ESG culture of the company.

Advocate a responsible corporate culture

Corporate culture represents the image of enterprises. Positive corporate culture can guide the positive development of enterprises, motivate employees, and virtually change their work behavior. The essence of ESG is a sense of responsibility, a sense of responsibility needed by employees to work, a sense of responsibility needed by enterprise management. According to the concept of ESG, enterprises fulfill their environmental protection obligations as social citizens and assume environmental responsibilities. The public responsibility of society must safeguard the interests of stakeholders; ensure sound and stable internal governance and be responsible for its own development. A corporate culture of advocating responsibility is to remind employees to be a responsible person and to be a responsible person. Thus, a responsible corporate culture is an important driving force for corporate ESG governance, making it easier for employees to understand the meaning of ESG and establish a responsible corporate image.

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