INTERNATIONAL JOURNAL OF FINANCIAL ECONOMICS (IJEFE) e-ISSN: 3063-3648
Vol. 1 No. 2 August 2024, page 447-458

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG) FACTORS IN FINANCIAL MANAGEMENT: A SYSTEMATIC REVIEW AND RESEARCH AGENDA

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Abstract

Environmental, Social, and Governance (ESG) factors play an increasingly important role in contemporary financial management. The integration of ESG into business strategy and financial decision-making not only reflects a company's responsibility to society and the environment, but also contributes to improved long-term financial performance. Companies that implement strong ESG practices tend to demonstrate better risk management, a stronger reputation, and greater appeal to responsible investors. In addition, a focus on ESG helps companies identify innovation opportunities, improve operational efficiency, and meet increasing stakeholder expectations. As such, ESG has become an integral component of modern financial management, influencing aspects ranging from capital allocation and investment appraisal to financial reporting and long-term growth strategies. In conclusion, this review confirms the importance of ESG factors in modern financial management and highlights its potential as an effective business strategy to achieve long-term financial success in a business environment that increasingly emphasises sustainability and social responsibility.

Keywords: Environmental, Social, Governance Factors, Financial Management.

Introduction

Over the last few decades, there has been a substantial paradigm change in business management and finances. It is no longer the case that corporations strive towards only financial return, they have also taken into account how their business operations affect the environment, society and governance structures. Environmental, Social and Governance issues (ESG), have become a necessary part of how investment strategies and financial management in general are created. (Markopoulos et al., 2020).

ESG factors play a crucial role in ensuring the long-term sustainability of companies and the global economy. By considering environmental impacts, companies can reduce risks related to climate change, resource scarcity and increasingly stringent environmental regulations (Harasheh & Provasi, 2023). A focus on social aspects helps build strong relationships with employees, customers and communities, which in turn can increase company loyalty and reputation. Good governance ensures ethical and transparent decision-making, reducing the risk of scandals and increasing investor confidence (Widyawati, 2020).

The integration of ESG factors into business strategy enables companies to better identify and manage risks and capitalise on new opportunities. For example, companies that are proactive in reducing their carbon footprint may be better prepared for stricter emissions regulations in the future. Similarly, companies that prioritise diversity and inclusion in the workplace can attract the best talent and increase innovation. Strong governance can help companies avoid conflicts of interest and corrupt practices that can undermine shareholder value (Ferrell, 2021).

ESG investing is becoming a more widespread phenomenon among investors since, over the long term, it gradually appears that those companies reporting strong ESG performance become more resilient and profitable to investors. This is still done by the due diligence process, but big institutional investors today ask for companies to disclose their ESG activities. Also, consumers, particularly those belonging to the younger age group, are more willing to back businesses that are focused on sustainability and social responsibility. This explains why companies are under pressure to enhance their ESG strategies.

Particularly ESG is understood and applied efficiently, and this leads to measures that could restrict companies or make them report more. The climate convention, the Paris Agreement, as well as the Sustainable development goals set by the UN, all serve as platforms to encourage people to make concerted efforts towards solving these issues. Today, in many states, it is required that the companies present a report on non-financial aspects, which also includes such metrics as ESG. The adjustment proposals such as the TCFD, seeks to standardise the ESG reporting system to enhance the efficiency of managing its disclosure and make the TCFD reports comprehensible to users. Meeting these standards not only becomes a matter of compliance but also enhances the companies' ability to raise capital and enter other countries' markets.

As development continues, more and more people accept and recognize the fact that global warming and other. Similarly, Green investments attract both investor's and society's attention nowadays. Customers and other parties have more and more been demanding that when undertaking corporate activities their environmental concerns are taken into account. Similar issues like equality, justice, and human rights have been put in focus and thus requires corporations to be more socially responsible. Companies that choose to ignore the social issues of the moment stand to lose a great amount of reputation and money (Oldford et al., 2022).

At the same time, it could be identified that not much has been accomplished with respect to how ESG considerations, in particular, can be incorporated into the everyday financial management functions of the firm. Most companies don't have a system in place that captures the formulation of ESG performance targets, or assesses ESG performance over time, which makes comparisons hard across companies and industries. It is apparent that changes should occur in the existing

financial analysis and valuation model to include all relevant ESG issues (Mohamad, 2020).

Modernization and the rise of big data create alternatives to attention and apply ESG knowledge within the frameworks of fundamental management processes of an organization, but as well, there are some concerns regarding confidentiality and security of such data (Moffitt et al., 2024).

Considering these complexities and dynamics, an overview of the current literature should be undertaken to explain the current position on the integration of ESG issues into financial management practices. Furthermore it is very pertinent to establish knowledge gaps and come up with practical solutions that will assist towards achieving sustainable and responsible financial management in the years to come.

Research Methods

The study in this research uses the literature method. Literature research method, also known as literature review, is a systematic approach to collecting, evaluating, and synthesising information from existing sources on a particular topic. (Alaslan, 2022); (Suyitno, 2021).

Results and Discussion

ESG (Environmental, Social, Governance) concept

ESG (Environmental, Social, and Governance) is a framework used to evaluate the performance of a company or organisation in three main aspects: environmental, social, and governance. The concept covers how companies manage their environmental impacts (such as energy use, waste management, and carbon emissions), how they interact with society and stakeholders (including labour practices, diversity, and community engagement), and how they exercise internal governance (including management structure, business ethics, and transparency) (Alkaraan et al., 2022). ESG has become an important factor in investment decision-making and corporate sustainability evaluation, reflecting the shift towards more responsible and sustainable business practices in the modern era (Klinger et al., 2022).

The components of ESG consist of three main interrelated pillars: Environmental, Social, and Governance. Environmental aspects include factors such as climate change, natural resource management, pollution, and green technology innovation. Social aspects include labour practices, human rights, diversity and inclusion, product safety, and community relations (Rahman & Alsayegh, 2021). Meanwhile, governance aspects focus on the company's leadership structure, board composition, business ethics, transparency, risk management, and regulatory

compliance. These three components work together to provide a comprehensive picture of sustainability and corporate responsibility, allowing stakeholders to assess not only financial performance, but also the long-term impact and operational ethics of the Company (Sharma et al., 2020).

Financial Management

Financial Management is a branch of management science that focuses on planning, managing, and controlling the financial resources of an organisation or company. Its main objective is to maximise firm value and shareholder wealth through effective and efficient financial decision-making. Financial management involves various activities such as financial planning, budgeting, working capital management, investment analysis, risk management, and financial reporting (Abhayawansa & Mooneeapen, 2022).

The scope of Financial Management covers several key areas in a company's financial operations. These include investment decisions (such as project selection and resource allocation), financing decisions (such as determining the optimal capital structure and sources of funding), dividend policy, working capital management, financial statement analysis, long-term financial planning, and financial risk management (Zumente & Bistrova, 2021). In addition, financial management also deals with aspects such as company valuation, mergers and acquisitions, financial restructuring, and compliance with financial regulations. In the modern era, financial management also increasingly considers non-financial factors such as environmental sustainability and corporate social responsibility in financial decision-making (Habib, 2023).

The core purpose of the firm’s financial management is the enhancement of the value of the firm and the wealth of its shareholders with the aid of a number of optimal financial decisions. Proper and timely management of financial resources makes it possible to minimize risks as well as enhance revenue generation. This objective includes several important aspects, such as: making sure there are adequate resources for the company’s operations and development, marketing a capital structure that has minimum cost, managing working capital well, enhancing investment decisions that are reasonable and productive, having a flexible dividend policy and effective financial weight (Kumar & Firoz, 2022). Furthermore, modern-day financial management also seeks to strike an equilibrium between maximizing profits and ensuring that environmental and social factors are also taken into account in business decisions. Therefore, the goals of financial management do not address only the health of the company, but rather recognize multiple perspectives and people, as well as the time-horizon for which the system function is intended. (Cek & Eyupoglu, 2020).

Relationship between ESG and Financial Management

Environmental, Social, and Governance (ESG) has become an increasingly important factor in modern financial management. The integration of ESG into financial management practices reflects a paradigm shift from a purely profit-orientated, short-term focus to a more holistic and sustainable approach to managing corporate finances. Financial management must now consider environmental impacts, social responsibility, and good governance practices in every financial decision taken (Zhang et al., 2022).

From an environmental perspective, financial management should consider how the company's investment and operational decisions impact the environment. This can include assessing risks related to climate change, efficient use of resources, and investment in environmentally friendly technologies. Financial decisions that pay attention to environmental aspects can help companies reduce regulatory risk, improve operational efficiency, and create new business opportunities in a low-carbon economy (Landi et al., 2022).

The social aspect of ESG requires financial management to consider the impact of corporate decisions on employees, customers and society at large. This can involve investments in employee welfare programmes, product safety, and community development initiatives. From a financial perspective, focusing on social aspects can improve corporate reputation, customer loyalty, and employee productivity, which in turn can improve long-term financial performance (Landi et al., 2022).

Governance in the ESG context is closely related to transparent and responsible financial management practices. This includes executive remuneration policies, board structure, business ethics and regulatory compliance. Financial management that prioritises good governance can increase investor confidence, reduce the risk of financial scandals, and improve access to capital. By integrating ESG into financial management, companies not only better manage risks but also create sustainable long-term value for all stakeholders (Saini et al., 2022).

The integration of ESG into financial management also affects the investment decision-making process and capital allocation. Companies that apply ESG principles in their financial management tend to be more selective in choosing investment projects, taking into account not only financial aspects but also environmental and social impacts. This may result in a change in portfolio diversification strategy, with more allocation to sectors that are considered more sustainable or companies with strong ESG practices (Razak et al., 2023).

The application of ESG in financial management also impacts a company's financial and non-financial reporting. There is a growing demand from investors,

regulators and other stakeholders for greater transparency regarding ESG performance. As a result, many companies now publish sustainability reports or integrate ESG information into their annual reports. This requires financial management to develop systems and processes that can accurately and consistently measure, track and report ESG metrics (Lim, 2024).

While the integration of ESG into financial management offers many benefits, it also presents its own challenges. One of the key challenges is quantitatively measuring and assessing ESG impacts, especially for hard-to-measure factors such as long-term social impacts (Ahmad et al., 2024). In addition, there is a potential trade-off between ESG objectives and short-term financial objectives, which requires careful balancing in decision-making. Financial management also needs to adapt to rapid regulatory changes related to ESG, which may affect the Company's financial and investment strategies (Huang, 2021).

In conclusion, the relationship between ESG and financial management has become increasingly close and inseparable in the modern business landscape. The integration of ESG into financial management practices is not only a trend, but has become a strategic imperative for companies that want to survive and thrive in the long term. Effective financial management must now be able to balance traditional financial objectives with environmental and social responsibilities, as well as good governance practices. By adopting an ESG approach, financial management can help companies better manage risks, identify new opportunities, enhance reputation, and ultimately create sustainable value for all stakeholders. Although challenges in implementation remain, the long-term benefits of integrating ESG into financial management far outweigh the short-term constraints, making it a critical component in a sustainable and responsible business strategy.

Environmental Factors, Social Factors, and Governance Factors on the Company's financial performance

Environmental, Social and Governance (ESG) factors have a significant impact on a company's financial performance. These three factors are interrelated and influence various operational and strategic aspects of the company, which in turn affect financial results.

Environmental factors relate to how companies manage their impact on the natural environment. Companies that are proactive in reducing their carbon footprint, using renewable energy, and implementing environmentally friendly business practices tend to experience increased operational efficiency and long-term cost reductions (Liu & Nemoto, 2021). For example, investments in energy-efficient technologies can reduce operational costs, while innovations in green products can open up new markets and increase revenues. In addition, companies with good environmental practices tend to face lower regulatory risk and have a better

reputation, which can increase share value and lower the cost of capital (Lee & Isa, 2023).

Social Factors include the company's relationships with employees, customers, suppliers, and the community. Companies that prioritise employee well-being, diversity and inclusion, and community engagement tend to have higher levels of employee productivity and retention, which contribute to operational efficiency and reduced costs related to employee turnover (Duque-Grisales & Aguilera-Caracuel, 2021). Good social practices can also increase customer loyalty and strengthen relationships with suppliers, which can result in increased sales and supply chain efficiency. In addition, a strong social reputation can protect companies from reputational and litigation risks, which can have a significant impact on financial performance (Constantinescu et al., 2021).

Governance factors relate to a company's leadership structure, business ethics practices, transparency and accountability. Companies with strong governance tend to have better decision-making, more effective risk management and higher levels of investor confidence. This can result in better access to capital at lower costs, as well as higher market valuations. Good governance practices can also reduce the risk of financial or ethical scandals that can seriously impact a company's financial performance. In addition, strong governance encourages innovation and long-term adaptability, which are essential for sustainable growth and profitability in a dynamic business environment (Amosh et al., 2023).

The integration of ESG factors into a company's business strategy and operations is not only an ethical responsibility, but can also provide a significant competitive advantage. Companies that successfully manage ESG factors well tend to be more resilient to market shocks and better prepared for future challenges. For example, companies that invest in green technology may be better prepared to face increasingly stringent environmental regulations, while companies with good labour practices may be better able to attract and retain top talent in a competitive labour market (Shakil, 2021).

However, it is important to note that the impact of ESG factors on financial performance may vary depending on the industry, company size, and geographical context. Some ESG initiatives may require significant initial investment before generating long-term financial benefits. Therefore, companies need to conduct a thorough analysis to identify the most relevant ESG areas and potentially have the greatest positive impact on their financial performance (Nițescu & Cristea, 2020).

Recent research shows that companies with high ESG ratings tend to outperform their peers in terms of long-term financial performance. This includes metrics such as return on equity (ROE), return on assets (ROA), and revenue growth. In addition, these companies often exhibit lower share price volatility and less bankruptcy risk, reflecting a lower perception of risk among investors (Lim, 2024).

In conclusion, Environmental, Social and Governance factors have a significant and multidimensional influence on corporate financial performance. While the impact may not always be immediate or short-term, the integration of ESG factors into business strategy can result in sustainable competitive advantage, higher operational efficiency, better risk management, and ultimately, stronger financial performance in the long run. Companies that adopt a holistic approach to ESG and align it with their business objectives are likely to see improvements not only in traditional financial metrics but also in overall business resilience and sustainability. As such, focusing on ESG is not just about 'doing the right thing', but also a smart business strategy to achieve long-term financial success.

Conclusion

Environmental, Social and Governance (ESG) factors have become an integral component of modern financial management. Systematic reviews have shown that the integration of ESG factors into corporate strategy and operations has a significant impact on financial performance, risk management, and long-term sustainability. Companies that successfully manage ESG aspects well tend to exhibit stronger financial performance, lower volatility, and greater resilience to market shocks.

While the impact of ESG on financial performance may vary depending on industry and geographic context, the overall trend shows a positive correlation between strong ESG practices and better financial metrics. These include improvements in return on equity (ROE), return on assets (ROA), and revenue growth. In addition, a focus on ESG has been shown to enhance corporate reputation, attract responsible investment, and help companies anticipate and manage regulatory and operational risks more effectively.

Future research agenda should focus on developing more sophisticated methods to measure and evaluate the impact of ESG on financial performance. This includes further investigation into how specific ESG factors affect various aspects of financial management, such as capital structure, investment decisions, and dividend policy. In addition, more research is needed to understand how ESG practices can be effectively integrated into different business models and how this can affect shareholder value in the long run.

Overall, this systematic review confirms the importance of ESG factors in contemporary financial management. Companies that adopt a holistic approach to ESG and align it with their business objectives are likely to see improvements not only in traditional financial metrics but also in overall business resilience and sustainability. As such, the integration of ESG into financial management is not only an ethical imperative, but also a smart business strategy to achieve long-term financial success

in an era where sustainability and social responsibility are increasingly becoming the primary focus of investors, consumers and other stakeholders.

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