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Role of ESG Performance in Shaping Market Performance: Evidence from Indian Listed Firms

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Abstract

In this paper, the relationship between the environmental, social and governance (ESG) performance and three market-oriented variables dividend payout (D/P) ratio, earnings per share (EPS) and price-to-earnings (P/E) ratio of the simulated sample of 100 listed Indian firms from 2018 to 2024 is explored. It provides an illustration of the extent to which overall ESG performance and its three components—environmental, social, and governance—may be related to firm-level market performance, once firm factors such as firm size, leverage, profitability, sales growth, cash holdings, firm age and time are controlled for in a fixed-effects panel regression. The hypothetical results suggest that the overall ESG scores are positively and statistically significantly correlated with the D/P ratio and EPS, while the correlation with P/E ratio is positive but not statistically significant. Overall, there is no clear evidence that either environmental or social performance are the strongest and most consistent positive predictors of D/P and EPS; however, governance is a positive predictor, as is the extent of the company's social performance, while environmental performance exhibits a mixed pattern and smaller negative association with D/P. Signaling, agency, stakeholder and resource-based perspectives are used to interpret the findings. Importantly, it is not observations from actual firms that are reported, but rather the data and estimated coefficients are illustrative; the results should therefore not be inferred as causal estimates in the Indian market. The paper is an empirical template that can be applied to actual data from firms.

Keywords: ESG; dividend payout; earnings per share; price-to-earnings ratio; panel data; India; fixed effects; corporate governance

1. Introduction

The Environmental, Social and Governance (ESG) principles have come into focus for companies' decision-making and capital-market evaluation processes. Sustainability information is not only utilized to assess the non-financial performance of companies, but also to make expectations regarding risk, profitability, governance quality and long-term value creation. Recent studies of listed companies in India show a positive association between ESG disclosure and accounting-based and market-based firm performance indicators (Veeravel et al., 2024). Indeed, in international context there is evidence that there is a link between ESG performance and corporate value and financial results, albeit of variable size and direction depending on the method of measurement, the institutional context and the individual pillar of ESG that is considered (Fatemi et al., 2018; Bhandari et al., 2022). Nevertheless, three of the above are worthy of special mention. First, the dividend payout ratio indicates the proportion of earnings paid out to shareholders and thus can offer insight into the cash generation ability and management's confidence. Second, earnings per share, which is the amount of earnings generated by each ordinary share in the firm, is a prime indicator of firm profitability that is closely monitored by investors. Third, the P/E ratio is a measure of the market's price of earnings, and hence of the expectations of investors regarding growth and risk. It is important to note that using these indicators interchangeably would mask potentially different transmission mechanisms between ESG performance and market outcomes.

This paper thus investigates if ESG performance is correlated with D/P ratio, EPS and P/E ratio and if the ESG components have different correlations with these measures. Analysis is based on a hypothetical panel provided in the source Draft. The paper has three goals: (i) to estimate the strength of the correlation between overall ESG performance and each market-performance measure; (ii) to isolate the contribution from each pillar (E, S, G); and (iii) to come up with implications for investors, managers, and policymakers; the paper explicitly acknowledges the illustrative nature of the data.

2. Review of Literature

The second measure was literature review and theoretical framework. The ESG–performance literature, for the most part, suggests that sustainability-related capabilities can impact firms through the following pathways: risk reduction, relationship with stakeholders, operational efficiency, reputation and access to capital. Fatemi et al. (2018) demonstrate that these strengths and weaknesses can lead to a corresponding rise and fall in firm value, and that the disclosure of the ESG dimensions can influence the perception of the underlying strength and weakness. In India, Veeravel et al. (2024) show that ESG disclosure is positively correlated with firm performance based on a dynamic panel model of the firms listed on the National Stock Exchange. They examine valuation outcomes in the present framework as a direct motivation to their study; one of the measures of market performance included in their study is the P/E ratio.

The relationship does not have to be the same for all performance measures. An ESG driven investment can be made that will involve some current spending but have future returns in terms of reduced risk, better stakeholder relations, increased operational resilience, or better reputation. Hence, other earnings indicators can react in a different manner to valuation multiples. This separation encourages the separate study of EPS and P/E, not as a single variable.

There is a rich literature on dividend policy, and in this context ESG performance could impact on financial outcomes. Better ESG performance may be linked to better earnings and reduced risk, and make it easier for the firm to distribute cash. Bilyay-Erdogan et al. (2023) find that, for a large sample of European listed companies, better ESG scores are associated with higher dividends and suggest that earnings and risk are two possible channels. This lends further credence to the thesis that ESG can be linked to dividend policy beyond disclosure to underlying financial conditions.

There is also a theoretical basis to argue that governance may be of special relevance. Managers can become more aligned with shareholders and more credible and predictable in their dividend policy by having strong governance mechanisms to limit managerial opportunism. The source draft hence expects a higher, positive impact on the social and governance aspects than on the environmental performance, but acknowledges that environmental investment could require near-term financing needs. We examine the ESG, EPS and P/E ratio. EPS and P/E are two different measures of market performance. Both EPS and P/E are related to the value of earnings to shareholders, but they are different reasons. EPS is directly related to the value of earnings to shareholders and P/E is related to the market's valuation of those earnings. ESG enhancements can boost EPS via efficiency, risk management, employee relationships or reputation; however, the impact on P/E will depend on whether investors adjust their assumptions regarding expected future growth and risk. The present hypothetical results are intentionally more conservative for the valuation multiple (Veeravel et al., 2024) as there is evidence of positive relationship between ESG disclosure and firm performance in India, in terms of P/E. This separation is also aligned with the disclosure of the non-mechanical benefit of ESG disclosure. The findings of Fatemi et al. (2018) suggest disclosure can change the relationship between positive (negative) environmental, social and governance characteristics and firm value. So, its information value and credibility could be as important as the actual score. The expected relationships are based on four complementary perspectives. Signaling theory suggests that the information which can be derived from the observables that a company conducts, reflects the unobservable of the company's characteristics (Spence, 1973). Therefore, good ESG scores could be a proxy for management ability, long-term perspective, risk sensitivity and organizational discipline. Second, agency theory points to the importance of governance on mitigating the conflicts between managers and shareholders (Jensen & Meckling, 1976). Improved governance can enhance the credibility of the dividend, the allocation of capital, and the monitoring of ESG performance, further connecting ESG performance to outcomes for shareholders. Third, in the stakeholder theory, it is argued that companies are able to generate value in part because of the quality of their relationships with employees, customers, communities, suppliers, regulators and investors. Improved stakeholder interaction can minimize disruption, reputational risk and contribute to more robust financial prospects. Fourth, the resource-based view (RBV) considers valuable and hard-to-replicate organizational resources and capabilities as a source of sustainable competitive advantage (Barney, 1991). ESG capabilities could be a component of such resources if they are integrated into the company's processes and relationships. Bhandari et al. (2022) also link ESG and stakeholder with the RBV stating that characteristics related to ESG can be relevant to sustained competitive advantage.

3. Hypotheses Development

- H1: The dividend payout (D/P) ratio is positively related to the overall ESG scores.
- H2: Higher overall ESG scores are positively associated with earnings per share (EPS).
- H3: The overall ESG score is statistically significantly correlated with the price to earnings ratio (P/E) in a positive direction.
- H4: The governance and social scores are more positively associated with D/P ratio and EPS than are the environmental scores, and the environmental performance may have mixed or negative short-run impacts on dividend payout.

3. Data and Methodology

The analysis is based on the hypothetical panel provided in the draft: 100 Indian listed firms are observed in the period 2018-2024. The balanced upper bound is thus 700 firm-year observations and the effective sample size is 680 observations. The source draft reads that the companies are similar to those of the NSE-100. As the data presented are purely hypothetical, the numerical figures given below are indicative. They are not provided as estimates based on observations from actual NSE or commercial-database observations. A hypothetical version should be replaced by an empirical version at future stage with realistic firm-year information and calculations should be reproduced.

3.1 Variables

Variable	Operational definition	Role
D/P ratio	Dividends per share ÷ earnings per share (%)	Dependent
EPS	Earnings per share (INR)	Dependent
P/E ratio	Market price per share ÷ earnings per share	Dependent
ESG score	Overall ESG score, 0–100	Main independent
E score	Environmental pillar score, 0–100	Pillar independent
S score	Social pillar score, 0–100	Pillar independent
G score	Governance pillar score, 0–100	Pillar independent
Firm size	Natural logarithm of total assets	Control

Leverage	Total debt ÷ total assets	Control
ROA	Net income ÷ total assets (%)	Control
Sales growth	Year-on-year revenue growth (%)	Control
Cash ratio	Cash and equivalents ÷ total assets	Control
Firm age	Years since incorporation	Control
Firm and year effects	Firm and calendar-year fixed effects	Fixed effects

Table 1. Variable definitions

3.2 Econometric specification

$$MarketPerformance_{i}t = \beta 0 + \beta 1\ ESG_{i}t + \gamma' Control\ s_{i}t + \mu_{i} + \lambda_{t} + \varepsilon_{i}t$$

where $MarketPerformance_{i}t$ denotes D/P ratio, EPS, or P/E ratio for firm i in year t; $ESG_{i}t$ is the overall ESG score; $Controls_{i}t$ is the vector of firm-level controls; μ_{i} represents firm fixed effects; λ_{t} represents year fixed effects; and $\varepsilon_{i}t$is the idiosyncratic error term. Standard errors are clustered at the firm level. The pillar-level specification replaces the composite ESG score with E, S, and G scores. This enables the analysis to identify whether the aggregate association is driven disproportionately by one or more ESG dimensions.

4. Results

4.1 Descriptive Statistics

Variable	Mean	SD	Min	Max
D/P ratio (%)	28.50	18.20	0.00	95.00
EPS (INR)	42.30	28.60	−12.50	185.00
P/E ratio	22.40	9.80	5.20	68.50
ESG score	52.30	14.20	18.00	88.00
Firm size (log assets)	10.40	1.10	7.80	13.20
Leverage	0.38	0.18	0.02	0.85
ROA (%)	8.20	4.50	−3.10	22.40
Sales growth (%)	9.50	12.30	−25.00	65.00
Cash ratio	0.12	0.09	0.01	0.55
Firm age (years)	22.50	12.30	3.00	65.00

Table 2. Descriptive statistics for the hypothetical sample

Note. All numbers are representative and provided in the draft for illustration purposes only. The descriptive profile suggests that there is significant variation across the firms in the key outcomes. Overall, the ESG performance of the illustrative sample appears to be moderately good with the mean ESG score of 52.30 and the substantial difference in EPS and P/E ratios suggests that there is a significant spread in profitability and valuation. The leverage distribution also shows that the financing structures of firms are significantly different. These patterns suggest enough variation in concepts for the illustrative fixed-effects analysis.

4.2 Fixed Effects Model

Variable	(1) D/P ratio	(2) EPS	(3) P/E ratio
ESG score	0.180*** (0.052)	0.320*** (0.095)	0.045 (0.038)
Firm size	2.100*** (0.420)	5.800*** (1.100)	1.200*** (0.450)
Leverage	−12.500*** (3.100)	−18.200*** (5.200)	−3.800** (1.800)
ROA	0.650*** (0.140)	1.850*** (0.320)	0.280*** (0.090)
Sales growth	0.120* (0.065)	0.450*** (0.110)	0.080** (0.040)
Cash ratio	8.500** (3.800)	12.300** (5.900)	2.100 (1.900)
Firm age	0.080 (0.060)	0.220* (0.110)	0.050 (0.045)
Constant	−15.200 (12.500)	−42.500 (28.300)	−8.200 (11.200)
Firm FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	680	680	680
Number of firms	100	100	100
Within R^2	0.24	0.27	0.18

Table 3. Fixed-effects regressions of market performance on overall ESG score

Note. Robust standard errors clustered by firm are in parentheses. *** $p < .01$, ** $p < .05$, * $p < .10$. All estimates are hypothetical.

The baseline specification shows a strong positive association between ESG performance and both D/P ratio and EPS and the relationship is statistically significant. The coefficient for the ESG is 0.180 for the D/P ratio and 0.320 for EPS. In the illustrative specification, then, a 10-point increase in ESG score is associated with an increase in the D/P ratio by 1.80 percentage points, and an increase in earnings per share (EPS) by INR 3.20, consistent with all other controls and fixed effects included in the specification. The coefficient on ESG for the P/E ratio is positive (0.045) but small enough that it doesn't meet the criteria for statistical significance. Therefore, the illustrative results are in favor of H1 and H2, but not H3, there is not enough statistical evidence. The distinction is relevant as it indicates that the relationship between ESG and market performance could work more effectively by the earnings and dividend potential other than by systematically expanding the valuation multiple.

The control variables also exhibit economically sensible relationships. Most specifications show that firm size is positively associated with the three outcomes, while ROA and sales growth have a positive relationship with the three outcomes.In most specifications, the three outcomes are positively associated with firm size, ROA, and sales growth, and negatively associated with leverage. However, these relationships should be viewed as conditional and not causal effects, since the data set is hypothetical.

4.3 Pillar-level analysis

Variable	(1) D/P ratio	(2) EPS	(3) P/E ratio
E score	−0.060* (0.032)	0.080 (0.055)	0.020 (0.025)
S score	0.140** (0.055)	0.210*** (0.062)	0.035 (0.028)
G score	0.220*** (0.058)	0.380*** (0.068)	0.060* (0.030)
Controls	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	680	680	680
Within R^2	0.25	0.28	0.19

Table 4. Fixed-effects regressions using E, S and G scores

Note. Robust standard errors clustered by firm are in parentheses. $*** \; p < .01, ** \; p < .05, * \; p < .10$. All estimates are hypothetical.

The pillar-level specification uncovers a differentiated ESG–performance relationship. Governance shows the strongest positive correlation with D/P ratio and EPS, with the social pillar also showing a positive correlation with the same. Governance is also somewhat positive for P/E. The findings support the agency theory perspective that it is possible to enhance managerial accountability and the credibility of financial policies geared to shareholder interests through governance. The opposite trend is observed in the case of environmental performance. The environmental coefficient is negative but is not strong enough to be significant for D/P ratio, and has no significant association with EPS or P/E. The suggested explanation seems to be that environmental investments can be costly in the present but may yield future gains and thus can decrease the near-term distributable cash. This is not a causal conclusion, but rather an interpretation of the hypothetical pattern. Overall, the results support partially the H4: governance and social performance are associated positively with D/P ratio and EPS, while the environmental pillar has mixed associations.

4.4 Robustness Analysis

Robustness test	Specification	Illustrative conclusion
Alternative dividend measure	Dividend yield replaces D/P ratio	Overall ESG and G/S effects remain positive and significant
Lagged ESG	$ESG_t - 1$ replaces ESG_t	D/P and EPS relationships remain similar; P/E remains insignificant

Industry subsamples	High-impact vs low-impact industries	ESG coefficients are larger in high-impact sectors
Random effects	RE specification estimated alongside FE	Qualitatively similar results; FE remains preferred

Table 5. Summary of illustrative robustness checks

Note- These robustness outcomes are ones that have been provided in the supplied draft and are potential. Before using them as empirical evidence they should be reproduced with real data. The strength of the robustness exercises helps to reinforce the results presented in the illustrative findings, especially the positive links between the ESG and D/P ratio and EPS. When ESG is lagged, it too remains significant, which offers a conceptual check for purely contemporaneous relationships. Nevertheless, robustness checks are not considered causal evidence, as real data and suitable identification methods are needed for causal evidence.

5. Discussion

Overall, the higher the ESG performance, the higher the dividend payout and EPS; the P/E is not statistically reliably associated with the ESG performance. However, the result is consistent with signalling theory, which would suggest that a high score on ESG would include information regarding managerial quality, risk management and long-term orientation (Spence, 1973). In addition, it is aligned with Bilyay-Erdogan et al. (2023), who propose that dividend payouts are related to ESG performance via two channels: earnings and risk. The result on the strong governance is especially in line with agency theory. Good corporate governance can diminish information and agency problems and it can also help to build trust that corporate resources are being used for the benefit of shareholders (Jensen & Meckling, 1976). Social performance could also be a stakeholder value-add as it may help to create employee commitment, customer trust, and reputational resilience, leading to improved earnings quality and earnings stability. It is noteworthy that there is no significant P/E effect. A company can boost profits but not its valuation multiple. In this context, ESG could show up as realised or expected profits, not in investors' ability to pay more for each dollar of profit. This interpretation aligns with evidence showing that disclosure and performance on ESG dimensions can have varying impacts on valuation, not always resulting in a single valuation premium. (Fatemi et al., 2018)

5.1 Implications for investors

The illustrative findings indicate that investors could benefit from using ESG information to evaluate dividend sustainability and earnings quality. Governance and social indicators could be given special consideration if the investment objective involves regular dividends to shareholders. It is important to note, however, that ESG scores are not the only factors to consider: leverage, profitability, liquidity, growth, industry characteristics and valuation conditions are still relevant.

5.2 Implications for managers

The results indicate that for managers, it is necessary to combine ESG with the financial strategy, beyond the disclosure exercise. The governance and social capabilities can bring relatively quick payoffs with regard to stakeholder confidence and financial stability. Investments in the environment may need a longer timeframe, therefore, managers must be very clear about the time frame they will expect cash-flow, risk reduction and strategic benefits.

5.3 Implications for policymakers and regulators

To capital-market participants, the comparability, credibility and assurance of ESG information can be more useful, for policymakers and regulators it can enhance the value and ease of use. Additionally, better alignment of sustainability reporting with financial reporting can also assist investors to identify when performance is improving or simply being reported for the objectives. As ESG data becomes more commonplace in corporate reporting and investment analysis, these implications are of special relevance in India as well.

6. Conclusion

The paper builds a structured framework to discuss the correlation between ESG performance and three market-based indicators: dividend payout ratio, EPS and P/E ratio. Hypothetical panel results suggest positive and significant links between overall ESG performance and D/P ratio and EPS, but not between ESG and P/E, while on the pillar level, governance and social performance are the main positive drivers of D/P ratio and EPS respectively, and environmental performance exhibits a mixed short-run relationship. The findings ought to be taken as a prima facie empirical model and not as representative of Indian firms. But the framework emphasizes the importance of not viewing ESG as a one-dimensional measure and the need to study the dividend policy, earnings, and valuation multiples separately. The next step for an empirical study to be publishable is to use real data for the firm-years rather than the hypothetical dataset; use transparent data sources; and apply appropriate endogeneity controls when re-estimating the models. The key restriction is that the data and regression results are only hypothetical. The results presented herein in terms of reported coefficients, significance level, descriptive statistics are merely illustrative and should not be extended to the Indian listed firms. The second restriction is related to causal inference. Actual relationships between ESG and performance could still be impacted by reverse causality, omitted time-varying factors, measurement error and the self-selection of ESG. There are three caveats to this, one being the measurement of ESG. ESG scores might reflect both the sustainability performance and the quality of disclosure, and can vary between rating providers. The fourth constraint relates to the limited time frame (2018–2024), and the more limited sample design. Future research could rely on real firm-level data, a variety of ESG data providers, dynamic panel estimators or credible quasi-experimental designs, and explicit endogeneity tests. The relationships between ESG and dividend and ESG and valuation can also be moderated by factors such as ownership structure, industry environmental intensity, financial constraints, institutional investment, and regulatory changes in future research. Another exciting opportunity is the impact of Digital transformation on ESG performance, where technology can enhance the measurement, reporting, monitoring and implementation of ESG principles.

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