

ESG and Commercial Sustainability: A Commercial Threat and Value Perspective

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ABSTRACT

Environmental, Social, and Governance(ESG) has come central to commercial strategy worldwide. However, ESG is a framework for business risk management and value preservation rather than philanthropy or activism. This chapter makes the case that ESG is not a moral requirement but rather a tool for lowering risk, safeguarding capital availability, and guaranteeing long-term business sustainability. by combining the concepts of fiscal threat pricing, agency proposition, legality proposition, and stakeholder proposition. This chapter make an attempt to explain how ESG capability reduces functional threat, improve stakeholder trust, minimize cost of capital, and enhances companies value. Additionally, it looks at ESG challenges as valuation catalysts that lead to unusual returns and heightened perceptions of danger.. Further, it provides a corporate-focused interpretation of ESG issues that is relevant to directors, policymakers, and researchers.

Keywords: ESG, corporate sustainability, governance, cost of capital, controversies, company value

INTRODUCTION

During the past decade, ESG issues have shifted from voluntary reporting to a corporate strategic focus. Moreover, investors, governments, and consumers assess firms on the basis of environmental, social, and governance criteria.

However, from the managerial perspective, ESG issues are not about “doing good”, they are about risk management and corporate survival.

Managers analyse decisions on the basis of four fundamental questions:

Does this raise costs?

Does this create risks?

Will investors react?

Are regulators going to intervene?

ESG factors are pertinent exclusively when they influence these four domains. Therefore, ESG should be regarded as a business strategy, rather than merely a social initiative.

Conceptual Basis

Theory of stakeholders

This theory highlights the reliance of businesses on different stakeholders: employees, customers, suppliers, communities, and investors. When stakeholders have confidence in the business, business operations become more consistent. ESG investments foster stakeholder confidence and reduce conflict.

Theory of Legitimacy

"Legitimacy theory is a framework highlighting how an organization functions within societal values and norms, focusing on a social contract between businesses and society that directs their relationship and expectations, incorporating non-financial disclosures regarding environmental and social matters."

Agency Theory

This theory is used to realize the relationship between the managers and shareholders. Business managers face pressure to perform short-term rather than long-term. Effective governance mechanisms mitigate the shareholders' problem by aligning managers' incentives with long-term ESG objectives.

Resource-Based View (RBV)

ESG investment can be viewed as a strategic resource. Companies that set up solid environmental processes, ethical supplier chains, and governance systems have a competitive edge that others can't copy.

Financial-Economic Model based on Risk Pricing

Finance is at the core of business decision-making. A simple structural model is $\text{Firm Value} = f(\text{Financial Controls, Operational Risk, ESG Capability, Governance, Macroeconomic Controls})$ Where:

ESG Capability decreases the expected future volatility of operational and regulatory cash flows.

ESG Controversies increase perceived risk which consequently elevates the anticipated cost of capital.

This corresponds to traditional asset pricing theory: lower expected volatility and better governance imply lower risk premium and higher valuation. The cost of capital and ESG ratings have been demonstrated to be significantly correlated by Empirical research in the industry.

LITERATURE REVIEW

Meta-studies and bibliometric syntheses

There is an increasing number of meta-analyses and bibliometric syntheses that present mixed but enlightening evidence: ESG-firm performance links are industry-, region-, and method-specific; negative valuation effects of controversy events are robust; and measurement heterogeneity is a fundamental challenge.

ESG and Cost of Capital

Industry studies and consulting reports demonstrate that improved ESG scores are linked to a reduced cost of capital for equity and debt capital, a finding that fits perfectly into the risk-value pricing paradigm. Empirical academic research (2023-2025) increasingly confirms the link, with a focus on endogeneity and measurement specifics.

Market responses and disputes

According to recent research, ESG disputes are associated with immediate abnormal returns, greater volatility, and long-term reputation consequences. Controversial studies demonstrate that they represent more reliable valuation events than standard ESG disclosures.

ESG as a Risk-Value Framework

From a corporate finance point of view, ESG has two channels of impact on firm value:

1. Risk reduction

2. Capital market perception

Having high ESG capability is associated with lower:

- Regulatory fines
- Environmental risks
- Legal risks
- Reputational shocks

Earnings volatility

Lower risk translates into lower cost of capital. When investors perceive lower risk, the firm enjoys:

- Lower equity risk premium
- Lower borrowing costs
- Increased institutional investment access

Ultimately, a lower cost of capital translates into higher firm value.

ESG Controversies as Valuation Catalysts

When a company's activities contradict publicly declared ESG commitments, an ESG controversy occurs. Environmental infractions, labor misconduct, data privacy violations, governance scandals, etc., are examples. When these events happen, it will lead to stock prices fall, investor confidence erodes, debt spreads widen, regulatory probes rise, etc. Financial markets may be willing to forgo temporary financial losses but will not abide the loss of trust. Therefore, ESG controversies are not merely ethical failures—they are financial events.

Proposed Conceptual Model

“Dominant Governance → Superior ESG Capability → Lower Operational Risk & High Stakeholder Relationships → Low Cost of Capital → Better Company Value”- Negative chain:

Low Governance/Greenwashing → ESG Controversy → High Perceived Risk → High Cost of Capital → Firm

Value Loss

This conceptual framework illustrates that ESG has financial outcomes through risk transmission and capital market perception.

Managerial Implications

ESG must be seen by managers as risk infrastructure rather than marketing. As a result, managerial responsibilities include improving internal controls, coordinating executive compensation with long-term plans, opposing insignificant ESG reporting, and closely monitoring ESG risks.

Short-term thinking and decisions on environmental or social issues may result in long-term financial consequences.

Policy Implications

It is essential that policymakers must formalize ESG reporting practices, improve transparency and comparability, reduce the possibility of greenwashing, and strengthen governance practice enforcement.

Clear regularity requirement not only reduce the information asymmetry but also uplift the investor confidence.

CONCLUSION

ESG needs to be acknowledged as a corporate survival tactic. Long-term competitiveness, investor perception, risk profiles, and capital access are all impacted. A strong ESG capacity increases corporate value and reduces perceptions of risk. Financial penalties and controversy are more likely to result from subpar ESG performance. ESG is therefore not about altruism or ethics. Maintaining operational viability, credibility, and investability in a cutthroat global marketplace is the goal.

The most crucial question facing company leaders is still, "How does this ESG issue impact long-term risk, investor confidence, and capital expenses?"

Incorporating ESG into this framework turns it from a regulatory burden into a source of competitive advantage.

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