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THE IMPACT OF ESG RATINGS ON FIRM FINANCIAL PERFORMANCE AND FOREIGN INSTITUTIONAL OWNERSHIP IN INDIA: A SYSTEMATIC LITERATURE REVIEW

Sarv Pallav Krishan Nandan[1], Dr. Sumita Sinku[2]

[1]Research Scholar, Department of Commerce, Delhi school of Economics, University of Delhi, New Delhi, India
[2]Assistant Professor, Department of Commerce, Faculty of Commerce and Business, Delhi school of Economics

Corresponding Author
Sarv Pallav Krishan Nandan,
sarvpallavk5@gmail.com

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ABSTRACT

This paper offers a systematic review relationship between financial performance of the form and ESG ratings in India is underexplored particularly, considering the impact it has on foreign institutional ownership. Through incorporation of the PRISMA framework, the study identified and synthesised research articles which were relevant to the context of India and published between the timeframe of 2018 and 2024. Drawing on frameworks like Agency Theory, and Stakeholder Theory the study findings imply that ESG performance is integral to enhance firm value and attract foreign investors in India. The study further highlighted the importance of regulatory and market factors shaping ESG investment decision. The study offered future research directions and practical implications for understanding the impact of ESG rating in foreign institutional ownership in India.

Keywords: ESG Performance, Firm Value, Foreign Institutional Ownership, Corporate Governance, Financial Performance, Systematic Literature Review and Emerging Markets

1. INTRODUCTION

1.1 RESEARCH CONTEXT

In an emerging market like India, Environmental, Social and Governance (ESG) performance is a crucial agent to shape corporate strategies on a global level. With Indian firms complying with global sustainability standards, ESG is attaining prominence to lure investors from foreign institutions. ESG performance is rendered as a key indicator to risk management, corporate resilience and long-term value creation. This according to Bhaskaran et al. (2020) and Saini et al. (2023) aligns with international investors' inclination to socially responsible enterprises. Regardless, this relationship between financial performance of the form and ESG ratings in India is underexplored particularly, considering the impact it has on foreign institutional ownership.

1.2 RESEARCH QUESTIONS

1. How do ESG ratings impact firm financial performance in Indian companies?

2. What is the relationship between ESG ratings and foreign institutional ownership in Indian firms?
3. What are the key mediating factors between ESG performance and financial outcomes in the Indian context?

In spite of the expanding interest on ESG's role in financial decision-making there persists a notable gap in literature concerning ESG's direct impact on institutional ownership and firm value within the context of India. Several studies such as those by Behl et al. (2022) and Alahdal et al. (2024) emphasize ESG performance positively influences financial outcomes and investor behavior of corporations in developed markets. Regardless, not many studies have been explored in the context of India, solely. As suggested by Kumar & Firoz (2022) and Barman & Mahakud (2024), India's unique market dynamics, socio-political factors and regulatory environment mandates further investigation around ESG factors' influence on corporate performance and investment decisions. This study therefore aims at bridging this gap by streamlining the focus on intersections of ESG ratings, institutional ownership in Indian firms, and financial performance in the context of foreign institutional investments with ESG becoming important criteria for investment.

1.3 LITERATURE GAP TABLE

Study	**Methodology**	**Geographic scope**	**Databases Used**	**ESG Measurement Approaches**	**Time Frame**	**Identified Research Opportunities**
Dash & Sethi	Quantitative analysis	India	Scopus	ESG scores, financial performance	2020 - 2024	Impact of ESG on investment-cash flow sensitivity
Barman & Mahakud (2024)	Regression analysis	Asia-Pacific	Web of Science	Policy uncertainty, sustainable disclosure	2020 - 2024	Role of policy and geopolitical risk on performance
Potharla et al. (2023)	Quantitative analysis	India	Scopus	CSR, Institutional Ownership	2020 - 2023	CSR's impact on firm performance and institutional ownership
Bhaskaran et al. (2020)	Empirical analysis	Global	Web of Science	ESG initiatives, wealth creation	2010 - 2019	Link between ESg and firm wealth creation
Fahad & Rahman (2020)	Regression analysis	Global	Scopus	CSR, Corporate governance	2015 - 2020	Corporate governance's role in CSR disclosure
Ganguly & Mishra (2023)	Quantitative analysis	India	Web of Science	CSR, firm value	2020 - 2023	Impact of CSR on firm value for politically connected firms
Behl et al. (2022)	Cross-lagged panel analysis	India	Scopus	ESG score, firm value	2015 - 2020	ESG's effect on firm value in the energy
DasGupta & Roy (2023)	Cross-country analysis	Global	Web of Science	ESG, performance feedback	2015 - 2023	ESG performance feedback and firm moderators
Hasan et al. (2022)	Industry analysis	India	Scopus	CSR disclosure, firm performance	2020 - 2022	Industry-specific CSR disclosure impacts
Kumar & Firoz	Theoretical analysis	India	Web of Science	ESG disclosures, financial performance	2015 - 2022	Accounting-based performance and ESG disclosures
Alahdel et al. (2024)	Empirical analysis	Gulf countries	Web of Science	ESG, Board gender diversity	2020 - 2024	Gender in diversity in ESG-performance relationship

Pathak et al. (2024)	Comparative study	India	Web of Science	Competitive advantage, CSR mandate	2015 - 2024	CSR impact mandate on competitive advantage of firms
Saini et al. (2023)	Systematic review	Global	Google Scholar	Financial variables and ESG	2010 - 2023	Link between ESG performance and financial variables

2. THEORETICAL FRAMEWORK

2.1 THEORIES

To understand the relationship between Environmental, Social and Governance (ESG) performance and outcomes of a firm, various theoretical perspectives are needed to obtain valuable insights.

STAKEHOLDER THEORY:

Stakeholder theory stresses that firms are needed to attend to the stakeholders' interest including employees, customers, shareholders and communities for ascertaining long-term success. The broader stakeholder interests are addressed by ESG practices by attending to social issues, governance and environmental responsibility. As mentioned by Bhaskaran et al. (2020) and Fahad & Rahman (2020) with expectations met of the stakeholders, firms are able to enhance their reputation, attract investments and improve their financial performance. DasGupta & Roy (2023) highlights that as suggested by the stakeholder theory, firms having high ESG scores tend to build trust and attract institutional investors prioritising responsible investment practices.

AGENCY THEORY:

The agency theory evaluates the relationships between agents and the principals, to determine the rise of conflicts of interest with their goals diverged. As per Fahad & Rahman (2020) ESG disclosures reduces asymmetrical information and aligns the managers' interest with that of the institutional investors. Institutional investors tend to have long-term horizons and they perceive high ESG performance as an indication to better risk management and governance feeding trust and investments. Potharla et al. (2023) suggests how agency theory helps understand why institutional investors prefer firms that hold strong ESG practices with agency costs mitigated and ascertain aligned objectives.

RESOURCE-BASED VIEW (RBV):

This implies that the resources and capabilities of a firm is integral for its competitive advantage and long-term performance. Firms that have high ESG scores possess valuable intangible resources like strong governance structures, positive reputation and effective risk management processes. According to Saini et al. (2023) these resources result in long-term value creation and improved financial performance. In this stance, Behl et al. (2022) mentions that RBV implies that ESG performance served as a strategic asset enhancing market position of the firm and increasing its attractiveness to foreign institutional investors.

2.2 LINKING THEORY TO RESEARCH QUESTIONS

When these theories are applied to the research questions, key insights are revealed. Application of stakeholder theory explains ESG practices influencing investor perception through improved stakeholder relations and how these results in greater foreign institutional ownership. Agency theory posits understanding of how ESG disclosures align institutional investors and managers interest in emerging males of India with governance issues being a grave concern (Barman & Mahakud, 2024). Finally, RBV accentuates how strong ESG practices serve as valuable resources helping firms attract foreign institutional investments through signaled long-term stability and risk mitigation (Ganguly & Mishra, 2023). Through these integrated theories, the study examines the complex interplay between ESG ratings, foreign institutional investment and firm performance in Indian context.

3. RESEARCH METHODS

3.1 PRISMA GUIDELINES IMPLEMENTATION

This study adheres to the 2020 PRISMA guidelines for systematic review of literature. It ensures a structured and transparent approach for the process of review and outlines a systematic procedure for selection of study, extraction of data and its synthesis. Following the defined research questions, the study opted for a comprehensive literature search, screening the articles for their eligibility and assessment of the quality of each article. Those studies that met the inclusion criteria were selected to detail the data extraction and follow the thematic synthesis.

3.2 DATABASE SELECTION

The primary databases were chosen for literature search was by using Scopus and Web of Science. These databases were particularly chosen given their comprehensive coverage to peer-reviewed articles relating to ESG, financial performance, corporate governance and those studies in particular that focus on India.

3.3 SEARCH ALGORITHM DEVELOPMENT

A targeted search was performed using different keywords combinations for ascertaining that the search is both comprehensive and relevant. The keywords included -

- ESG ratings/performance
- Financial performance
- Foreign institutional investors
- Indian companies
- Corporate governance
- Sustainable finance

These search strings were tailored for emphasizing on ESG-related research for the Indian markets while focusing on the foreign institutional investment and corporate performance.

3.4 ARTICLE SELECTION PROCESS (INCLUSION/EXCLUSION CRITERIA)

Initial screening was based on aspects such as Peer-reviewed status, language (English), time period (2020-2024), and relevance to the Indian market. For the quality assessment aspects such as methodological rigor, data reliability, relevance to research questions, and citation impact were evaluated.

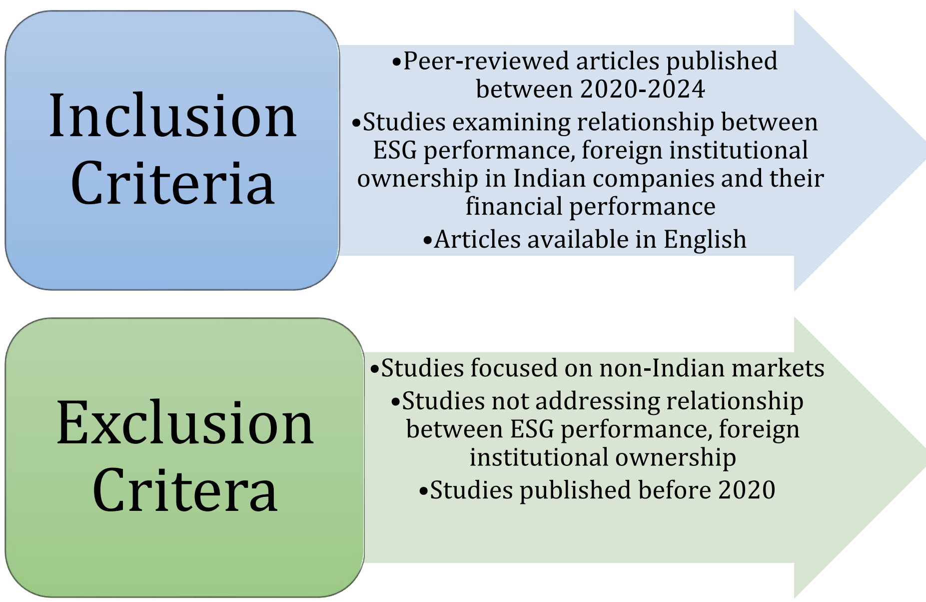
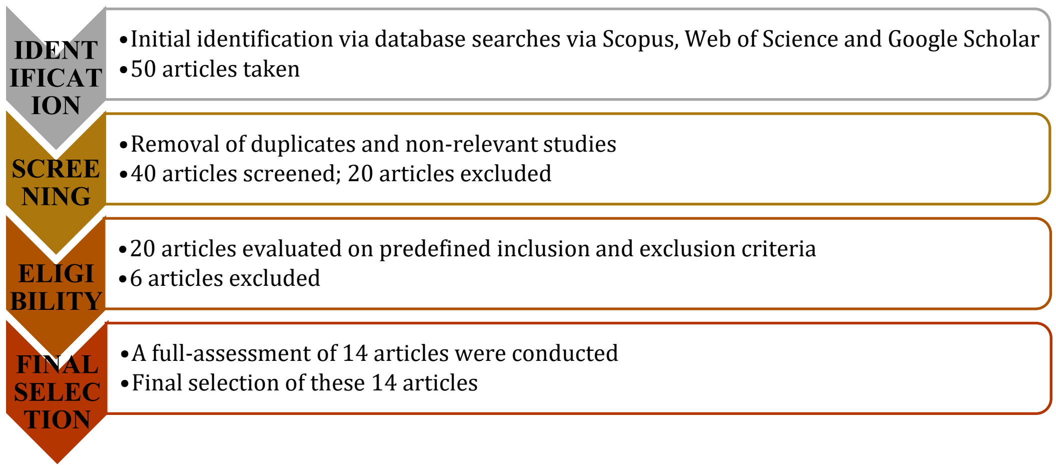


Figure 1: Inclusion and Exclusion Criteria

Source: Created by Author

Additionally, a content analysis framework was also employed for synthesising the findings obtained from the reviewed literature. This framework streamlined the focus in identification of themes, patterns and trends across the selected studies on ESG performance and its influence on institutional ownership and financial performance in Indian firms.

PRISMA



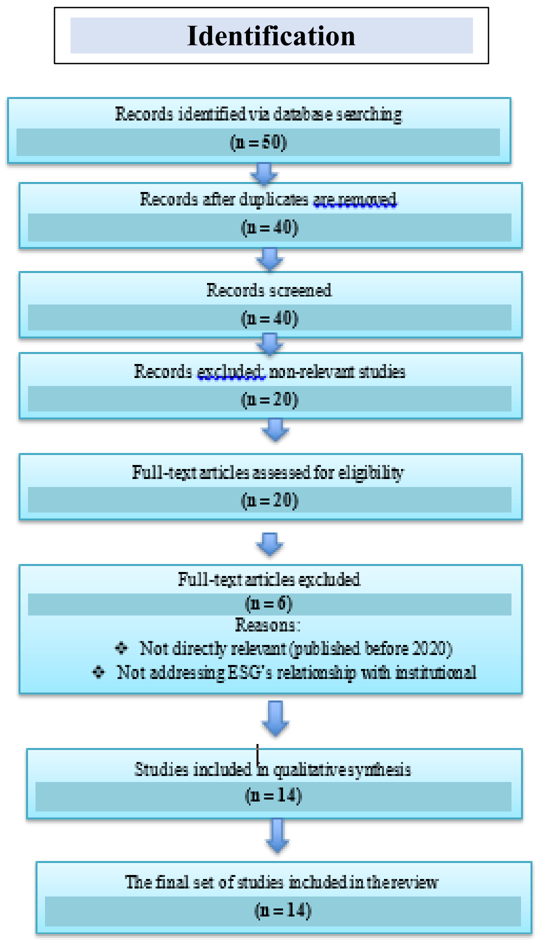


Figure 2: PRISMA Flow Chart
Source: Created by Author

3.5 QUALITY CONTROL MEASURES
VALIDITY CHECKS

For ascertaining the validity of findings, the eligibility of studies at each stage of the systematic review as performed. By comparing the key insights obtained from multiple sources, the cross-validation of dinings were performed which also ensured reliability and consistency. Prior to citing validation of interpretation of complex themes, many peer-reviewed papers were consulted prior to interpreting them especially under the influence of those that were related to ESG performance particularly in the context of India. In addition, the entire process of systematic review considered peer review articles for methodology and interpretation for enhancing credibility of the study.

BIAS ASSESSMENT

For minimising potential distortions, the study performed a rigorous bias assessment. Efforts were out to mitigate publication bias inclusive of both peer-reviewed articles and high-quality gray literature. Moreover, databases that had diverse indexing criteria were put to search for ensuring comprehensive coverage in this study. Next, to address geographic bias, the studies that focused exclusively on India were considered to ensure that the findings contextualise within the global ESG performance standards for facilitating broader relevance. By limiting the review to publications from 2020 to 2024, the study helped minimise temporal biases. This also ensures that the insights presented in this research study also best reflect the most recent trends and regulator changes in ESG practices. By conducting a detailed evaluation of research design, analytical frameworks and data collection methods of each study the research ensured methodological rigor. The study made an attempt to ensure that studies with unverified claims and weak methodologies did not serve a part in this study. Through incorporation of these quality control measures, the review process was able to uphold high standards of reliability and validity to ensure robust and actionable findings.

4. FINDINGS ANALYSIS FRAMEWORK

4.1 ESG RATING IMPACT ON FINANCIAL PERFORMANCE

Many of the recent studies have focused on the impact of ESG rating on financial performance. While examining the relationship between ESG rating and market-based measures like valuation multiples and stick routers; Behl et al. (2022) in their study demonstrates how firms with higher ESG scores in the energy sector experiences positive stock return implying that investors reward companies with better sustainability practices. In addition, firms that have higher ESG ratings tend to hold better valuation multiples as these ratings imply lower risk and better prospects in the long-term that increases confidence among investors. ESG's impact on firm performance can also be assessed through accounting-based measures like Return on Assets (ROA) and Return on Equity (ROE).

Kumar and Firoz (2022) demonstrate how firms having robust ESG practices hold higher ROE and ROA with initiatives that result in cost savings and enhanced reputational capital which boosts profitability. In India, firms investing in CSR activities marked a notable improvement in ROE catalysed by consumer loyalty and an efficient workforce (Ganguly and Mishra, 2023). Additionally, risk measures such as volatility and cost of capital are influenced by ESG performance. As per Dash and Sethi (2024) firms holding better ESG scores enjoy a reduced capital costs with investors perceiving them less frisky. Moreover, companies holding strong ESG ratings exhibit lower volatility with them being prepared to handle fluctuations of market and long-term risks that reinforces their stability and attracts investors.

4.2 ESG AND FOREIGN INSTITUTIONAL OWNERSHIP

ESG's performance and foreign institutional ownership (FIO) seeks profound attention in the developing markets especially India. As determined by Saini et al. (2023) firms having better ESG ratings lure greater FIO with foreign investors making sustainability a priority in their investment decisions. These studies demonstrate how investment patterns project clear preference for firms holding high ESG scores with these firms being perceived to be better aligned with long-term and ethical goals of foreign investors. With reference to ownership thresholds, higher ESG performance results in increased institutional holding especially for firms meeting certain social and environmental standards (Ganguly and Mishra, 2023). Investor horizons too, differ as foreign investors have an inclination toward firms with high ESG ratings because of a belief that these firms comparatively would deliver long-term returns in opposition to short-term profit-seeking. Furthermore, geographic source of investment too serves a rudimentary role. Foreign investors from regions having stringent social and environmental regulations like North America and Europe tend to be more preferred to invest in firms with strong ESG profiles (Alahdal et al., 2024). This is relevant for emerging markets like India with institutional investors demanding higher ESG standards prior to making investments.

4.3 MEDIATING FACTORS

Firm characteristics like age, size and industry play a significant role to influence the relationship between financial performance and ESG ratings. Firms that are larger have higher accessibility to resources for implementation of ESG initiatives, improving their performance. Industry-specific dynamics too serve as a mediating factor especially with energy and manufacturing sectors facing higher environmental risks being benefited from strong ESG practices. This is mainly because such practices reduce regulatory scrutiny and operational risks. Another crucial factor is governance structures wherein companies holding strong corporate governance would effectively implement ESG practices that improve the financial outcomes. As determined by Alahdal et al. (2024) diversity and transparency of board and governance is what enhances the performance of ESG and improves the stability of the firm. Such a regulatory environment is what serves as a mediator to this relationship. In regions of India, the mandatory ESG disclosures and the Security and Exchange Board of India (SEBI) is what motivates corporate behaviour and improves perception of the market. Moreover, market conditions further influence the intensity of impact on financial performance. In essence of economic stability ESG factors hold a pronounced effect on performance which during downturns allow strong ESG framework to fare better because of their capability of effectively managing crises.

4.4 INDIA-SPECIFIC CONTEXTUAL FACTORS

ESG performance relationship and its molding is particularly served by the India-specific context. India's regulatory framework has significantly evolved wherein SEBI's mandated disclosures on ESG ascertain greater corporate transparency and driven investments toward firms that are responsible. Another contextual factor is market development wherein, with Indian market maturity a focus is grown on sustainability that increasingly integrated domestic and foreign investors to ESG in their decision-making process. India's cultural aspects further influence ESG practices perception and implementation. With a growing emphasis on CSR embedded in the corporate culture of India, firms having strong ESG and CSR performance are perceived favourable by consumers and investors. Because of India's institutional environment, corporate behaviour of firms is shaped. Moreover sustainability initiatives under government incentives alongside growing pressure from global investors to comply with ESG standards trigger the importance ESG performance holds in the Indian market.

5. DISCUSSION FRAMEWORK

5.1 THEORETICAL IMPLICATIONS

This research accentuates key theoretical frameworks applicable to relationship between ESG performance and firm value especially in the context of India. As emphasized by the stakeholder theory firms are needed to cater to the interest of the diverse stakeholders. The study findings affirm this theory implying that firms having high ESG ratings tend to be better positioned for management of stakeholder expectations. For example, as demonstrated by Kumar and Firoz (2022) and Dash and Sethi (2024) ESG-aligned companies attain higher stock returns with lower risks which emphasizes the value of adopting stakeholder-centric practices. This further promotes long-term loyalty and trust, integral in emerging economies like India with institutional frameworks being matured. Agency theory is what attends to conflicts of interests between shareholder and management offering insights. The ESG disclosures act as mechanisms to enhance accountability and transparency reducing agency conflicts. As indicated by Behl et al. (2022)' study, foreign institutional investors are what prioritises ESG-compliant firms because of inherent government improvements. ESG initiatives therefore serve as a catalyst for managerial efficiency, reduced cost of capital and attracting long-term investment.

Institutional theory on the other hand is particularly relevant to understand adoption of ESG in India. This further implies how formal and informal rules like societal norms and regulatory mandates influence firms. SEBI mandates ESG disclosures through regulatory frameworks compelling firms in India for adopting sustainable practices as evident in work of Pathak et al. (2024). On a similar stance, societal and cultural expectations concerning sustainability drive firms to align with global ESG standards for maintaining their competitiveness in the international markets. The Resource-Based View (RBV) serves a critical lens for examining ESG initiatives acting as a strategic resource for the provision of competitive advantages. Firms that make investments in ESG practice are what serves intangible assets like employee satisfaction, innovation capacity and brand reputation. For instance, as highlighted by Bhaskaran et al. (2020) firms having strong ESG commitments are what attain greater wealth creation that reinforces the concept of sustainable practices differentiating firms in markets that are increasingly competitive.

5.2 PRACTICAL IMPLICATIONS

The research findings hold substantial practical implications for various stakeholders:

FOR CORPORATE MANAGEMENT

ESG integration needs to be prioritized as a strategic imperative by the managers by embedding sustainability into operations like implementation of diversity policies, use of renewable energy and adherence to ethical governance practices. As demonstrated by Ganguly and Mishra (2023) firms with high ESG scores are what benefit from improved confidence of investors and substantial reduction of operations risks. Companies are also needed to ensure ESG disclosures quality for enhanced transparency and attraction of foreign investments. As mentioned by Behl et al. (2022) by tailoring ESG practices to contexts that are specific to industry impact could be maximised especially for the energy sector.

FOR INVESTORS

The research findings offer critical insights for investors at both domestic and international levels. ESG ratings are dependable indicators to growth potential and financial stability. Investors that hold long-term horizons are needed to prioritise ESG-compliant firms for reducing exposure to reputation and regulatory risks. Moreover, investors can make use of ESG scores in the firm as a metric to assess the alignment of the firm with that of its global sustainability standards that enables portfolios being better diversified across the emerging markets like India.

FOR POLICYMAKERS

Regulators play a prime role in shaping adoption of ESG. The capability of regulatory investors to promote sustainability is accentuated through the success of SEBI’s mandatory ESG disclosure framework. Enhancing compliance mechanisms and introducing incentives like tax benefits for ESG investments must be of prime focus for policymakers. As Saini et al. (2023) ntes by aligning ESG regulators with international standards Indian firms can favourably serve as attractive investment destinations for foreign capital. Policymakers are also needed to consider capacity-building programs for helping equip firms with necessary tools and expertise for implementation of effective ESG.

FOR ESG RATING AGENCIES

The research findings imply that there is a need for standardized ESG rating methodology for ascertaining reliability and consistency. Investor perception can be shaped by rating agencies which further can help shape discrepancies between rating systems that cause trust issues. Agencies therefore are needed to work together with greater transparency for building trust in scoring processes so as to integrate localised factors which reflects the challenges and opportunities in emerging markets like that of India.

5.3 FUTURE RESEARCH DIRECTIONS

In spite of the progressiveness in understanding the relationship between ESG performance and firm value, there are notable gaps prevalent that offer avenues for future research. Further studies are needed to be directed to address methodological limitations with employed advanced econometric techniques and robust datasets. For example, despite cross-sectional analyses being common, they fail in capturing the essence of dynamic nature behind ESG impacts. Therefore, by employing panel data or time-series deeper insights could be obtained into the causality between financial performance and ESG initiatives. Future studies are also needed to pay heed toward expansion of scope of analysis for inclusion of non-financial mediators like employee satisfaction, innovation capacity and brand equity that enriches understanding of broader implications of ESG. Moreover, factors such as ownership structure, market conditions and firm size must be further intervened for capturing heterogeneity across geographies and industries.

Although most existing studies emphasize on short-term relationship, it is imperative to discuss longitudinal research for assessing the long-term effects of ESG initiatives on firm value. For instance, by analyzing the performance of firms’ over economic cycles as a response to external shocks, this could facilitate valuable insights into sustainability of ESG benefits. Moreover, comparative studies analyzing ESG impacts across emerging markets could also extend a broader end of perspective to illustrate factors like institutional, cultural and regulatory aspects shaping sustainability outcomes. By exploring these differences with respect to nations like India, China or BRICS nations, deeper insights could be revealed into the unique opportunities and challenges concerning the firms in this context.

6. CONCLUSION

This systematic review of literature has explored the relationship between environmental, social and governance (ESG) performance and financial outcomes while streamlining the focus to the context of India. Through this analysis, ESG ratings' dual role has been projected to serve as drivers of firm value and attractive agent for foreign institutional investment. By taking market-based measures like valuation multiples and stock returns consistent positive correlations were ascertained with high ESG scores. This demonstrates how investors tend to reward sustainable practices over time. On a similar stance, accounting-based metrics such as return on equity (ROE) and return on assets (ROA) have reinforced the financial contributions to implementing ESG. While studies underscore the contribution of ESG adherence in enhancing investor confidence, institutional ownership has emerged as a significant factor. In spite of advancements in ESG research, gaps are prevalent wherein future studies are needed to explore comparative analysis across different geographies and industries to track the evolving trends. With these concern areas being addressed the researchers can make substantial contributions to understanding the transformative potential of ESG in promoting social and financial sustainability.

CONFLICT OF INTERESTS

None.

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APPENDICES

APPENDIX 1

PROCESS DOCUMENTATION

Aspect	**Details**
Search strategy details	Systematic searchers performed across databases like web of science, Google Scholar and Scopus by using Boolean operators and keywords like "ESG, India, and financial performance'.
Selection criteria	Inclusion criteria: peer-reviewed articles (2018-2024 studies). Studies focused on ESG and financial outcomes in India. Exclusion criteria: non-English studies, non-peer-reviewed sources.
Quality assessment	Studies evaluated using a structured checklist covering methodological rigour, data validity and relevance.
Data extraction methods	Data extracted into standardised template with fields for author, title, methodology, key findings, and relevance to research questions.

APPENDIX 2

RESULTS DOCUMENTATION

Aspect	**Details**
Findings synthesis	Data synthesised by grouping findings under thematic headings - ESG ratings' impact Mediating factors India-specific contextual influences
Statistical analyses	Simple descriptive statistics - Frequency of certain methodologies Geographical focus Use of qualitative overview of selected studies

Thematic analysis	Qualitative coding for identification of recurring themes in ESG's relationship with foreign institutional investment and financial performance
Pattern identification	Patterns identified across styles - Sector-specific ESG benefits Factors like market conditions and governance mediating observed outcomes.

APPENDIX 3
SEARCH STRINGS USED

Primary keywords	ESG, Social, Governance, Environmental
Secondary keywords	Corporate governance, investment, financial performance and institutional ownership
Boolean operators	(ESG) OR (Environmental, Social, Governance) AND (India) AND (Financial performance) OR (Investment)
Databases searched	Web of Science, Google Scholar, Scopus, EBSCOhost
Language filters	English
Timeframe filters	2018-2024

APPENDIX 4
INCLUSION/EXCLUSION CRITERIA

Criterion Type	**Inclusion Criteria**	**Exclusion Criteria**
Language	English	Non-English
Publication Type	Peer-reviewed journal articles	Gray literature, conference proceedings
Timeframe	Published between 2018-2024	Published before 2018
Relevance	Focus on financial outcomes, institutional ownership or ESG performance in India	Studies irrelevant to ESG themes or unrelated geographies
Methodology	Empirical studies having clear outcomes and defined methodologies	Theoretical papers without empirical validation

APPENDIX 5
DATA EXTRACTION TEMPLATES

Field	**Description**
Author (s)	Names of authors of the study
Title	Title of research paper
Year	Year of publication
Journal	Name of the journal where article was published

Research objectives	Key research questions or objectives of the study
Methodology	Research design and used methods
Key findings	Major results or conclusions from the study
Relevance to research	Contributions of dindings to the current study
Citations for future reference	Page numbers or specific quotes to be included as citations