

Study on the Impact of ESG Performance on Corporate Financial Performance

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Abstract: As an advanced force in green transformation, the new energy vehicle industry has increasingly become an important part of the development of the new economy and new-quality productive forces in recent years. To further demonstrate the effect of its ESG practices on high-quality development, the impact of relevant enterprises' ESG practices on financial performance holds typical research value. This paper takes Company A as a case study, based on its financial data in recent years, constructs a financial performance evaluation system from four dimensions: profitability, operating capacity, solvency, and development capacity, and explores the correlation between ESG performance and financial performance by combining ESG rating reports and corporate practices.

Keywords: ESG; New Energy; Financial Performance

1 Introduction

Driven by the deepening of global climate governance and the accelerated implementation of China's "dual carbon" strategy, the domestic energy structure is constantly shifting from fossil energy with high pollution to clean energy as the main force, and a variety of new energy industries are developing vigorously. On the Chinese side, General Secretary Xi Jinping made a solemn commitment at the United Nations General Assembly in September 2020 that China will reach the carbon peak by 2030 and strive to achieve carbon neutrality by 2060. Green transformation and green development are urgent for China's industrial sector, and relevant theoretical research and guidance are urgently needed to point out the direction for future development. As a new-quality productive force industry that is highly in line with the concept of green development, the new energy vehicle industry should play a better leading role in this process. However, the current financial performance evaluation system of China's new energy vehicle enterprises still pursues the traditional financial performance goal, which is to maximize their own profits. It does not take into account the performance of environmental, social, and governance dimensions, nor does it realize that these performances are not completely conflicting with traditional performance. The transformation of enterprises' ESG practices from passive compliance out of necessity to active value-creating investment has become a key way to reshape their core competitiveness. As a major battlefield for new energy technological innovation, the ESG practices of the new energy vehicle industry are not only related to environmental benefits but also profoundly affect the operational efficiency of enterprises through technological innovation, supply chain collaboration, and stakeholder management.

2 Analysis of the Impact of ESG Performance on Company A's Financial Performance

2.1 Profitability Analysis

For the analysis of profitability, this study first selects two indicators as the basis for analysis, namely Return on Equity (ROE) and Return on Assets (ROA), which can well reflect a company's profitability. From 2019 to 2023, Company A's ROE soared from 3.45% to 23.06%, and ROA increased from 1.09% to 5.35%, significantly outperforming the industry average (the ROE of the automotive industry was only 2.46% in 2023). This growth is due to technological innovation and market expansion on the one hand, and on the other hand, it is closely related to the value enhancement brought by its ESG practices. From a more detailed perspective, Company A's ROE and ROA rose sharply in 2022, which was accompanied by the upgrade of Company A's ESG rating from Grade A in 2021 to Grade AA in 2022. This also indirectly confirms the relationship between ESG and financial performance.

At the same time, there are two main reasons for the significant decline in Company A's ROA and ROE in 2021. Firstly, the price of upstream raw materials of Company A rose sharply in 2021. Secondly, after the proposal of the dual carbon goal in September 2020, the growth

of Company A's costs and expenses accelerated suddenly, thus affecting the net profit. It can be seen from the above chart data that although its R&D expenses and management expenses are constantly increasing, there was a more significant increase between 2021 and 2022. This is because Company A fulfilled its ESG responsibilities, introduced and trained innovative talents, and increased R&D expenses. During the epidemic period, Company A increased its employee salary and welfare, expanded the scale of employees, and increased investment in the social dimension of ESG practices to ensure social employment. The increase in non-operating expenses mainly includes various donations made by Company A to the society. These all constitute the input costs in the social dimension (S) of ESG practices, demonstrating Company A's determination to increase investment and deepen practices in the social dimension of ESG.

Objectively, these expenses have indeed increased various costs of Company A, leading to a decline in net profit. As a result, Company A's ROA and ROE dropped significantly in 2021. In 2022, although the growth rate of costs and expenses further accelerated, due to the expansion of Company A's overall scale and the continuous deepening and normalization of ESG practices, after two years of experience and gradual entry into the right track, the average cost and expense decreased, and the effect of ESG practices finally began to show. In 2022 and 2023, Company A truly began to enjoy the dividends of ESG practice investment. The growth rates of both ROA and ROE were quite significant in these two years, and Company A's profitability did undergo a huge change with the cost investment in ESG practices.

In the environmental dimension, although the total greenhouse gas emissions of Company A increased due to the expansion of production scale, its unit emission density continued to decline. This is due to the application of renewable energy, the construction of zero-carbon parks, and the optimization of energy management. Such measures not only reduce environmental risks but also attract ESG-sensitive consumers through the "green brand", supporting business expansion. The long-term benefits of environmental investment were concentratedly released after 2022, with ROE jumping from 4.7% in 2021 to 15.7% in 2022. This further confirms the lag in the effect of green technology on improving profitability as mentioned earlier.

In the social dimension, Company A takes the protection of employees' rights and interests as the core of its operations. It reduces employees' living costs through low-cost dormitories, commuter trains, and car purchase subsidies. The number of working days lost due to work-related injuries has decreased for three consecutive years, effectively reducing downtime losses and compensation expenses. In 2023, the turnover rate of female employees was lower than the industry average. The stability of human capital drove ROA to increase by 19% year-on-year (4.49% in 2022 and 5.34% in 2023). At the same time, investment in social welfare (such as disaster donations, education assistance, and support for vulnerable groups) has strengthened the brand's credibility, indirectly improved customer loyalty, and the implicit value of fulfilling social responsibilities has gradually been transformed into profitable market value.

Finally, in the governance dimension, Company A has built a full-process digital risk control system. Through intelligent production and supply chain optimization, it has increased production efficiency to the industry-leading level. Industry-university cooperation has well accelerated the transformation efficiency of technology. A strict governance structure (such as the board of directors' regular internal control evaluation) has effectively reduced the production risks of the enterprise. From 2020 to 2023, the fluctuation range of Company A's ROE was much smaller than the industry average, reflecting that the stability of governance guarantees the good performance of financial performance.

Company A's ESG practices have formed a differentiated competitive advantage different from its peers by reducing costs through environmental technology, increasing value through social trust, and improving efficiency through governance efficiency. Its ROE increased against the trend to 15.7% during the industry loss in 2022 and further widened the gap in 2023, verifying the transformation of ESG investment from cost consumption to value addition. In the future, if it deepens the low-carbon and sustainable economic layout, ESG practices may further release the financial performance potential of its environmental dimension, providing a Chinese sample for global automobile enterprises to achieve the coordinated development of ESG and profitability.

2.2 Operating Capacity Analysis

The second part is the analysis of Company A's operating capacity. Here, two indicators are also selected first to analyze the company's operating capacity, namely inventory turnover rate and total asset turnover rate. From 2019 to 2023, Company A's inventory turnover rate increased from 4.12 to 5.77, and the total asset turnover rate increased from 0.65 to 1.03. During the same period, the inventory turnover rate

of the automotive industry decreased from 5.91 to 5.01, and the total asset turnover rate only slightly increased from 0.66 to 0.68. This performance highlights the key role of ESG practices in optimizing asset utilization efficiency and supply chains.

In the environmental dimension, Company A has reduced energy consumption in the production process, optimized the production process, and shortened the product production and delivery cycle through the construction of zero-carbon parks. In 2022, Company A's inventory turnover rate increased to 5.75, a 39.6% increase compared with 2019, far exceeding the industry performance during the same period (the industry inventory turnover rate decreased by 15.2%). Green technology not only reduces environmental risks but also promotes the improvement of asset turnover efficiency through efficient production.

In the social dimension, Company A has significantly reduced the employee turnover rate through welfare measures such as low-cost dormitories, commuter trains, and car purchase subsidies. The stability of employees directly improves the continuity of production and reduces the efficiency loss caused by personnel replacement. From 2021 to 2023, Company A's total asset turnover rate increased from 0.87 to 1.03, while the industry remained unchanged at 0.68 during the same period, demonstrating the positive impact of employee well-being on asset turnover efficiency.

In the governance dimension, Company A has built a full-process digital risk control system. Through intelligent production and supply chain optimization, it has significantly improved the inventory management level and the efficiency of asset use. In 2022, Company A's inventory turnover rate increased by 14.5% year-on-year, and the total asset turnover rate increased by 23%. During the same period, the industry's inventory turnover rate decreased by 6.9%, and the total asset turnover rate only increased by 2.9%. A strict ESG governance structure (such as the board of directors' regular internal control evaluation) has further reduced operational risks and ensured the efficiency and stability of asset use.

In terms of product quality, it can also be found that ESG practices have improved Company A's operating capacity and asset utilization efficiency. ESG practices focus on customer experience, so they implement very strict control over automobile quality and keep the product recall rate at a very low level. The recall rates in 2019, 2020, and 2023 were all 0. Through a very low recall rate, the operation efficiency of the enterprise's products and capital has been improved, and there is no need to increase its own operating costs due to product returns and exchanges, which reduces the operating and profit efficiency. The slight increase in the recall rate in 2021 was precisely because Company A entered the period of scale expansion and did not adapt to the larger production scale for a while, leading to such fluctuations.

2.3 Solvency Analysis

The analysis of solvency first focuses on the current ratio and asset-liability ratio. First of all, it is worth noting that under the background of dual carbon, the information required by ESG for enterprises to disclose can enhance the information transparency of enterprises, reduce the information asymmetry between enterprises and creditors. At the same time, good ESG practices will win a good social reputation for enterprises, which are conducive to enterprises gaining the trust of creditors. In the process of ESG practice, with the reduction of government subsidies and the increasingly fierce industry competition, the risk of Company A's debt operation will remain at a high level due to the optimization of the supply chain and the improvement of independent R&D capabilities. The overall current ratio has been less than 1 for a long time and shows a downward trend, which also leads to greater short-term financial risks. It can be seen that Company A's current ratio dropped significantly in 2022. This is because, for the needs of ESG practice development, Company A increased more short-term accounts payable within one year, contract liabilities caused by R&D of new products, and doubled other payables in that year, including medical funds and payables to some suppliers. The increase in these liabilities has led to a significant increase in the enterprise's current liabilities, thereby causing a significant decline in the enterprise's current ratio and weakening the enterprise's short-term solvency. However, since Company A is still in a development period with high profitability and has relevant government subsidies, the enterprise can still maintain a good short-term solvency.

In terms of the asset-liability ratio for long-term solvency, it can be seen that Company A's asset-liability ratio has maintained an upward trend overall and has been higher than the industry average. This shows that Company A has a stronger ability to operate with debt. Under the background of dual carbon, compared with its peers in the automotive industry, Company A has a stronger ability to operate with

debt, a higher financial leverage, a better leverage effect, and a larger production scale that can be leveraged. At the same time, compared with its peers such as NIO and XPeng, Company A's debt level has always been maintained at a relatively stable level. With its high and stable profitability, the enterprise has a good long-term solvency and a strong ability to resist risks.

2.4 Development Capacity Analysis

The last part is the discussion on Company A's development capacity. First, the revenue growth rate and profit growth rate are selected to explore the changes in Company A's development capacity caused by ESG. From 2019 to 2023, Company A's revenue growth rate increased from -0.02 to 0.42, and the net profit growth rate increased from -0.4 to 0.77. During the same period, the revenue growth rate of the automotive industry increased from 0.08 to 0.16, and the net profit growth rate increased from -2.32 to 0.37. Company A's development capacity is significantly better than the industry average, which is closely related to Company A's ESG practices. The significant decline in Company A's net profit growth rate in 2021, as discussed when talking about profitability, is mainly due to the following reasons. Firstly, the price increase of upstream raw materials of Company A in 2021 compressed the profit space. Secondly, the investment in ESG practices under the dual carbon background increased, leading to the rise of various expenses. Thirdly, the expansion of Company A's production and sales scale led to the increase of financial expenses, and it has not yet adapted to the current large production scale, resulting in the failure of synchronous profit growth.

In the environmental dimension, Company A has invested heavily in green technology R&D, actively expanded the application of renewable energy, and promoted the construction of "zero-carbon parks". These measures have enabled Company A to establish a distinct green energy brand image in the new energy vehicle market and attract a large number of consumers who agree with the concept of environmental protection. With the continuous growth of consumers' demand for green products, Company A has continuously expanded its market share by virtue of its image advantage of green concepts, promoting the continuous growth of operating income. In 2022, the sales volume of Company A's new energy vehicles increased significantly, and the revenue growth rate reached 0.96. Green technological innovation has brought new profit growth space for Company A, making it far exceed the industry level during the same period and laying a solid foundation for profit growth.

In the social dimension, Company A actively fulfills its social responsibilities, protects employees' rights and interests in various ways, and vigorously carries out social welfare activities. A stable workforce provides a solid human guarantee for the sustainable development of the enterprise. Employees actively devote themselves to work, promoting the improvement of product quality and the innovative development of the enterprise. Public welfare activities have enhanced the social reputation and influence of the brand and strengthened consumers' recognition of the brand.

In the governance dimension, Company A has established a sound corporate governance system and a strict decision-making mechanism, built a digital risk control system, and improved operational efficiency and decision-making quality. A strict ESG governance structure ensures that corporate decisions are in line with the long-term development strategy, effectively reduces operational risks, supports the continuous growth of the enterprise's operating income and profits, and maintains a good development trend in the complex and changeable market environment.

Company A's excellent performance in terms of development capacity benefits from its active ESG practices in the three dimensions of environment, society, and governance. Through green brand building, stable employee development, and improved governance efficiency, Company A has formed a strong driving force for development and stood out in the industry.

3 Conclusions

This study takes Company A as a case to conduct an in-depth analysis of the impact of ESG performance on corporate financial performance. The study finds that Company A's active practices in the three dimensions of environment, society, and governance have significantly improved its financial performance, and it is better than the industry average in terms of profitability, operating capacity, long-term solvency, and development capacity.

the case of Company A strongly proves that in the new energy vehicle industry, there is a close positive correlation between ESG per-

formance and financial performance. ESG practices can create sustainable financial value for enterprises, and the “ESG premium” is also applicable to the new energy vehicle industry with high R&D investment.

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