

ESG score analysis as an indicator for investment decisions and sustainable growth

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Abstract

Environment, social, and governance (ESG) is a principle that prioritizes sustainable development, investment, and business activities according to three criteria: environmental, social, and governance. ESG scores are a benchmark for evaluating an entity's sustainability. ESG scores can be used to certify an entity's sustainable development and other types of sustainability. On the other hand, much literature shows that ESG scores cannot measure sustainable development due to an entity's inability to understand ESG principles, resulting in greenwashing practices. This literature review uses descriptive qualitative methods. The literature review aims to examine the challenges and problems related to ESG and the phenomenon of greenwashing practices. Indirectly, greenwashing practices increase ESG scores, but if we look at the proper factors, it violates ESG principles. Hopefully, this literature review will help future research regarding ESG factors influencing business investment and sustainability.

JEL classifications: G11, G24, M14

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1. Introduction

According to the World Population Review (2021), Indonesia is one of the largest contributors of plastic waste to the world's oceans, after the Philippines, India, Malaysia, and China. The bottled water industry is the main cause. Waste from the industry, such as plastic bottles, cups, and sachets, is often carelessly disposed of, causing environmental pollution on land, rivers, and the sea.

According to the Indonesian Plastics Industry Association (Inaplas) and the Central Statistics Agency (BPS), Indonesia's bottled water industry produces 64 million tons of waste annually, of which 3.2 million tons is plastic. Of this amount, branded bottled water products contribute 226,000 tons, with 46,000 tons being plastic glass waste, which has no recycling value and pollutes the environment. It can be concluded that the phenomenon occurring in the bottled water industry contradicts the ESG principles, where transparency and environmental responsibility should be a top priority for companies to ensure sustainability and trust from consumers and investors.

ESG is a standard that companies use to run operations related to environmental, social, and governance principles. Companies that abide by ESG principles are an important assessment for investors. Investors are more interested in companies that comply with ESG principles because they are better in various aspects, such as sustainability, resources, efficiency, and finance (Lokuwaduge & De Silva, 2022). Investors can evaluate a company's accountability and long-term durability by paying attention to these principles. Businesses prioritizing ESG are considered moral, well-managed, and better equipped for long-term success.

Consequently, academics, managers, and investors need an effective way to evaluate businesses based on ESG criteria to classify them as socially responsible. Business investment and sustainability have become a major concern for investors (Ahmad et al., 2024). ESG-related factors are criteria that investors consider when making decisions about business investment and sustainability. Investors assess how companies handle social and environmental issues based on ESG performance. A company with a low ESG Score will likely face many ESG-related problems and conflicts. Conversely, a higher ESG score indicates better performance and the company is operating more sustainably (Ahmad et al., 2024).

ESG score measures how well an organization addresses environmental, social, and governance issues. Therefore, companies need to ensure that their score reflects real efforts in sustainability, not just a misleading marketing strategy. According to Serban et al. (2022), ESG indicators show the impact of corporate performance practices from an ethical point of view and assess whether the company is acting morally and ethically. It also looks at the real impact of the company's practices on its business performance.

The quality of ESG data, the reliability of ESG scores, and the accuracy of ESG data reveal a company's financial performance. Therefore, data quality significantly influences rating agencies, investors, and companies in the form of a precise picture of sustainable growth. When ESG indicators accurately reflect a company's performance, investors can use the information in their business assessment.

However, there are cases where companies that show good ESG performance violate sustainability principles, known as greenwashing. Greenwashing is a practice where companies or organizations give a deceptive impression that their products or policies are more environmentally friendly than they are. Therefore, this study examines the role of ESG Score indicators in supporting investment decisions and performance assessment for stakeholders, as well as how it relates to greenwashing practices in a company.

2. Literature review

2.1. Stakeholder theory

The stakeholder theory states that company managers must be responsible to various groups interested in the company. Stakeholder management aims to design effective strategies for managing stakeholder relationships. Stakeholders can support the company's success if their relationships are well-managed (Wu et al., 2020).

The stakeholder theory emphasizes that management should consider the interests of all stakeholders in order to increase corporate value through sustainable and responsible activities. As a stakeholder, investors increasingly use ESG data in their investment decisions. Companies realize that disclosing ESG information is critical to building a positive reputation in the eyes of stakeholders, especially when addressing environmental issues effectively and responsibly. The company strives to disclose complete information about the company, especially ESG information, to gain support from stakeholders so that the company can achieve sustainability and long-term success.

2.2. Environment, social and governance (ESG)

ESG is a broad concept that determines non-financial imperatives for an organization (Julius & Sacipto, 2020). It is the practice of measuring, disclosing, and holding all stakeholders accountable. It describes factors used to measure the non-financial impact of certain investments and companies. Simultaneously, it magnifies various business and investment opportunities. While ESG data may not be generalizable, experts argue that it can assist companies in adjusting to environmental changes and be included in a company's competitive strategy (De Freitas Netto et al., 2020).

Environment is a criterion that includes the energy taken and waste generated by the company, the resources needed, and the impact on living things, including carbon emissions and climate change. Every company uses resources and energy that affect the environment.

Social is a criterion that discusses the company's reputation in society and business institutions. Social criteria include diversity, inclusion, and labor relations. Every company operates in a wider and more diverse society.

Governance is the set of internal rules, controls, and procedures that a company applies to govern itself, make effective decisions, comply with the law, and meet the needs of external stakeholders. Every company that is incorporated requires governance.

2.3. Environment, social and governance (ESG) score

ESG scores consist of ratings in three main categories: environmental (e.g., environmental impacts, resource consumption, biodiversity impacts, and waste management), social (e.g., impacts on communities and suppliers, working conditions, and other social impacts), and governance (e.g., organizational transparency, relationships with shareholders and boards of directors, executive compensation, and board diversity).

ESG scores were created due to the need to assess companies based on the three criteria to identify the best-performing companies in each aspect (Yu et al., 2018). Private companies focus on portfolio management, and investors use various types of data to generate new data that meets the needs of investors, both quantifiable and non-quantifiable, to create ESG scores. Organizations that are in the process of receiving or updating ESG scores use self-reporting metrics audited by the company.

The main advantage of ESG scores is that they anticipate financial risks caused by dishonest acts (e.g., corruption, child labor) or accidents (e.g., oil spills, nuclear accidents, destruction of the natural environment). The popularity of ESG scores stems from the anticipation that responsible businesses will be prosperous as responsible investment strategies result in better returns on investment in previous years (Sipiczki, 2022).

In addition, ESG scores serve as a way to differentiate bad businesses (those without ESG scores) from good businesses (those with ESG scores) and show that the company can address ESG challenges. However, as a long-term investment, it represents less risk because it anticipates the threat of global warming and other social or environmental issues that will impact the company's profitability. In addition, a high ESG score can positively impact a company's financial performance.

2.4. ESG score and investment

Investment is the commitment of a certain amount of funds or other resources to obtain a certain amount of profit in the future. Bodie et al. (2014) define investment as a current commitment in the form of assets or other resources in the hope of obtaining benefits in the future. Meanwhile, Jones (2014) defines investment as an activity that uses money today intending to obtain an asset in the future.

In sustainable investing, investors consider the impact of investments on the environment, society, and corporate governance. They want to ensure that investments provide long-term financial returns and positive benefits to the environment and society. This approach reflects the investors' awareness of the importance of considering their investments' social and environmental impacts and the desire to contribute positively to sustainability issues.

2.5. ESG score, sustainability, and greenwashing

Sustainability is the quality of a human activity that can be carried out without depleting available resources and without damaging the environment so that the needs of future generations are still met while maintaining the balance of the environment and natural resources. According to Halid et al. (2023), sustainability reflects a change in business mindset. It places companies that want to survive and succeed in a new role where paying attention to stakeholders' interests is necessary.

Companies that only see their business activities as producing products or services for customers to maximize short-term profits without paying attention to social and environmental aspects will not gain a competitive advantage. Furthermore, Halid et al. (2023) emphasized that companies implementing sustainability in their operational activities can save costs and increase revenue. Doing so positively impacts the environment, has positive implications on the company's economic benefits, and strengthens relationships with stakeholders.

Greenwashing is a form of information wastage because it creates a false image that can potentially harm an organization (Kölbel et al., 2020). Therefore, greenwashing is not the same as having a poor environmental performance record because "a company can have a poor record without presenting positive information about itself, or it can have a relatively good record while promoting its positive actions so that the public fails to discuss its (slight) negative impact on the environment".

Hernández (2023) differentiates definitions of greenwashing into two main categories: a definition focusing on the attributes of the object and a definition focusing on the process behind the object. Object attributes consider the consistency between the characteristics of the object and the company's statement regarding the greenness of the object. This view defines greenwashing as "false advertising", "advertising and labeling that promises more environmental benefits than it delivers", and "unsubstantiated or misleading claims about the environmental or social benefits of a product".

On the other hand, process attributes focus on the communication process. Specifically, it considers the efforts that companies have made to communicate the greenness of a product in relation to efforts to increase the legitimacy of the product's actual environmental friendliness. One example of the process attribute is the definition put forward by Greenpeace, which is the most cited in the literature. It defines greenwashing as "the act of misleading consumers

regarding a company's environmental practices or the environmental benefits of a product or service". Li et al. (2023) define greenwashing as promoting environmentally friendly programs to divert attention from an organization's environmentally unfriendly or less beneficial activities. Senadheera et al. (2021) argue that to be considered greenwashing, the "action" must be intentional and imply intentional deception.

3. Research methods

This study focuses on investment decisions and sustainable growth based on ESG Score indicator analysis.

3.1. Data resources

The data sources for this study were obtained from a thorough review of articles in journals, books, research reports, and other relevant sources regarding ESG Score, investment decisions, and sustainable growth from 2020 to 2024.

3.2. Data collection technique

We used keywords related to ESG Score, investment decision, and sustainable growth in the literature search. Web of Science, Scopus, and Google Scholar are the most popular databases. In the second stage of article screening and selection, all articles found were added to the Mendeley Reference Management Software. Each article was examined based on the title, abstract, and full content to determine its relevance to the subject of this study. In the third stage, the selected articles were synthesized and further analyzed to better understand the contextual interrelationships. All relevant findings were carefully evaluated to compile a preliminary overview of the concepts of ESG Score, investment decisions, and sustainability growth.

4. Result and discussion

4.1. The effect of ESG score indicators on investment decision-making and sustainable growth

Investors are motivated to invest due to moral intensity, the desire for long-term profit and sustainable investment returns, and the belief in socially and environmentally responsible investments. The desire to positively impact through investment has increased awareness of environmental and social issues. Investors are also influenced by expectations of the impact of their investment, changes in company behavior, and the resulting co-benefits. A better asset pricing model can influence investor motivation through the ESG Score.

ESG Score is used as a reference in making investment decisions because it provides information about a company's performance in managing risks and opportunities related to environmental, social, and governance issues. Sustainability-oriented investors see the ESG Score as an important indicator for assessing long-term investment risks and opportunities and ensuring their investments align with ESG values. Investors use the ESG Score to evaluate a company's social and environmental responsibilities and their potential impact on long-term value. As such, the score helps investors make more sustainable and responsible investment decisions.

In addition, the ESG Score can measure sustainability by evaluating how companies address environmental, social, and governance issues in their operations. It reflects sustainable business practices, corporate social impact, and transparency in reporting. The ESG Score provides an overview of the extent to which a company is committed to responsible and sustainable business practices in the long term. It influences the investment level and sustainability decisions by providing more comprehensive information to investors. Sustainability-oriented investors tend to be attracted to companies with a high ESG Score

because it reflects responsible and sustainable business practices, influencing long-term investment decisions and helping to encourage more sustainable business practices.

The following is a literature review that proves ESG scores are a special concern for stakeholders, especially when making investment decisions.

Table 1. Literature review of ESG and investment

No.	Authors	Country	Result
1	Lhutfi et al. (2024)	Indonesia	The study conducted on 79 companies listed on the IDX show that CSR disclosure and SDGs positively affect ESG scores. Implementing CSR-related policies and commitments will provide added value to the company, as reflected by its ESG score. It attempts to prove that ESG scores can mediate investment decisions described through Earning Per Share (EPS), which affects investor perceptions, strengthens the company's reputation, and provides access to resources needed for long-term growth.
2	Senadheera et al. (2021)	Korea	ESG scores can influence investment decisions. Companies with high ESG scores tend to attract sustainability-oriented and environmentally friendly investors (Nordea Equity Research, 2017). Investors and stakeholders use ESG scores to obtain information necessary for long-term decision-making (Balluchi et al., 2021). Thus, ESG scores can be important in assessing a company's performance and environmental impact, influencing investor interest.
3	Clement et al. (2022)	North America	The ESG scores consist of three main categories: environmental (environmental impacts, consumption of natural resources, biodiversity impacts, and waste management), social (impacts on communities and suppliers, working conditions, and other social impacts), and governance (organizational transparency, board diversity, executive compensation and the relationship between shareholders and the board of directors). ESG scores are one of the differentiators between good and bad businesses because they show that a company can overcome existing challenges and changes. It affects a better return on investment than the previous year. ESG scores can influence investment decisions because investors are more interested in companies responsible for ESG and sustainability issues.
4	Daugaard (2019)	UK	The investment level based on ESG is higher than conventional investment because the pattern of investor funds flows based on the ethical and social values of the company.
5	Halid et al. (2023)	Malaysia	Based on concerns about corporate sustainability, the United Nations Principles of Responsible Investment encourage investors to consider ESG factors as non-financial indicators when making investment decisions.
6	Yudha and Rahman (2024)	Indonesia	ESG disclosure positively affect investment efficiency because it illustrates good company performance through increased company transparency, reduced agency problems, and information asymmetry. Consequently, investment decisions are more efficient.

4.2. The Effect of ESG in detecting greenwashing practices in the company

ESG can influence greenwashing practices. A company can reduce the likelihood of greenwashing practices by properly implementing ESG principles (such as transparency, environmental sustainability, and governance). With a strong ESG focus, companies tend to be

more honest and consistent in communicating their environmental, social, and governance efforts.

In addition, greenwashing practices can affect ESG and sustainable investment because they create a false image of a company's environmentally friendly practices without real actions that support sustainability. Subsequently, it may affect a company's ESG assessment and investors' sustainable investment decisions. The gap between the constructed image and actual practices can lead to distrust and negative environmental and sustainability impacts.

Greenwashing practices can be detrimental to a company's ESG Score. When greenwashing practices are uncovered, it reduces investor and public confidence in a company's sustainability and transparency, affecting the company's ESG Score assessment. Thus, greenwashing can damage a company's reputation and reduce its ESG Score. Table 2 lists the literature that discusses the link between ESG and greenwashing.

Table 2. Literature review on ESG and greenwashing

No.	Authors	Country	Result
1	Julius and Sacipto (2020)	Indonesia	Companies use greenwashing as a strategy to create an image of an environmentally friendly company, hoping that investors will view it favorably in terms of sustainability. The government regulated sustainable finance investment listed in POJK Number 51/POJK.03/ 2017 to reduce greenwashing. It requires the Financial Services Institutions (LJK) to prepare a Sustainable Finance Action Plan.
2	Wu et al. (2020)	USA	Greenwashing can be detected using ESG by measuring the transparency of information that a company provides. Investment decisions might be influenced by information transparency. The information transparency level can be a trigger for greenwashing practices. If transparency is low, the possibility of greenwashing practices and excessive investment is higher, and vice versa.
3	Li et al. (2023)	China	Greenwashing practices will negatively impact the company. The higher the greenwashing level, the lower the desire to invest in the company.

5. Conclusion

The synthesized journals show that the ESG Score affects long-term investment decisions and a company's sustainable growth. ESG Score helps identify financial risks that affect company performance by focusing on ESG factors. In addition, ESG plays a role in detecting greenwashing practices in companies by encouraging transparency, sustainability, and honest and consistent governance.

Implementing ESG benefits companies financially, improves them in the eyes of the public, and creates better relationships with their stakeholders. Companies can generate sustainable value in the long run by considering non-financial factors such as environmental and social impacts. ESG scores are crucial for companies in making investment decisions and achieving sustainable growth, implying the need to produce sustainability reports objectively and honestly.

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