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Effects of Country- and Firm-Specific Factors on ESG Performance: A Cross-Country Analysis for Emerging Markets

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Abstract: - This paper aims to shed the light on factors influencing ESG performance in emerging markets. This paper employed data from 20 emerging markets from 2013-2022 and investigated factors which classified into 2 dimensions, country- and firm- specific factors. Country specific factors include economic growth, level of corruption, legal system, and economic equality. Firm specific factors are firm size, capital structure, performance, and free cash flows. Pooled OLS regression controlled for country- and year- fixed effect are employed. The results show that number of firms that reported ESG performance has increased as well as the average ESG score has risen over the past a decade. Results on country-specific determinants reveal that GDP growth is negatively impact on ESG performance. A company based in common law countries shows higher ESG performance. In addition, size and debt-to-equity ratio are positively influence ESG performance. These results suggest both company and country characteristics effect ESG performance in emerging market. Thus, investors who seek for ESG performance should give more attention on these factors for making their decision.

Keywords: Emerging market, Sustainable, ESG, Firm Specifics, Country Characteristics

1. Introduction

Due to the rapidly change in economic situation, sustainable investment has become more concern among investors, firms, and policy makers. Non-financial performance, such as environment, social and governance have received more attention and been widely discussed. There are number of evidence suggested that this can create firm value (e.g. Cormier and Magnan, 2007; Patterson, 2013; Fatemi et al., 2018; Miralles-Quirós et al., 2019; Aydoğmuş et al., 2022; Boulhaga et al, 2023). As a result, Environment Social and Governance performance (ESG performance, hereafter) has been widely discussed. Nevertheless, the factor influencing ESG performance is yet unclear. Emerging markets is a developing nation which its economy is in transition. Emerging market nations experience strong economic growth and have its own characteristics which are much different to developed markets. For instance, most investors and corporations in emerging markets are yet mainly focus on financial performance. Corporations seek for its own benefit more than stakeholders' benefit. Also, emerging markets still faces many problems which different to those developed market, such as corruption, environment, human rights, corporate governance, etc. Subsequently, the objective of this paper is to investigate factors influencing ESG performance in emerging markets using data from 20 emerging markets between 2013-2022. Contributions of this paper are three folds. First, this paper fills the gap in the literature related to ESG performance determinants which are mainly employed data from developed markets Therefore, results of this study present whether the empirical evidence in developed market can be carry over to emerging market. Second, this paper gives direction to the regulators who want to promote ESG performance. Third, this paper gives guidelines to investors who want to focus on sustainable investment on how to select firm. Results of this paper show that both country- and firm-specific factors and impact on ESG performance although firm-specific factors are more important. Firm in a country using civil law system receive higher ESG performance. Economic growth is statistically negatively impact on ESG performance while Firm size and firm leverage are positively statistically impact on ESG performance. Nonetheless, when the region level is examined, the results specifically depend on region

The remainder of this paper is organised as follows. Section 2 outlines background and motivation of this study. Section 3 describes theoretical framework and literature review. Section 4 provides research design including data and methodology used in this study. Section 5 shows results and discussion. Section 6 gives overall conclusions.

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2. Background

The United Nations (UN) has approved the Sustainable Development Goals (SDGs), containing with the 17 goals as a guideline for developing our World's communities (Huber et al., 2018). This includes the concept of Principles of Responsible Investment (PRI), which is focusing on the sustainable investment. The environment, social and governance (ESG) become the three main concern of the sustainable investment. Investors believe that the ESG would assist the confident of firm's stakeholders, leading to the decline in business risk and a gradual increase in long-term growth. Therefore, investors would take these points for their decisions. Due to the fact that investors pay more attention to sustainable investment, a question of what factors will affect ESG performance is raised. Number of studies in the past have studied factors affecting ESG performance. However, these studies are often limited to developed countries, and studies in emerging markets are still limited. Most studies in emerging market are still focused primarily in specific countries and investigated on some firm specific factors. Nonetheless, study on emerging market in aggregate level is not existed. Therefore, the determinants of ESG performance in emerging market cannot be concluded. Specifically, in global investment, investors are likely to diversify their portfolio in many countries. Subsequently, not only firm characteristics but country characteristics should also be considered.

Emerging markets is a country that is in transition from low-income economy toward a modern economy. These countries have several characteristics which are different to those developed market. Emerging markets experience high growth economy. Legal and stakeholder protection is not as concise as developed market. These countries are less concern about social and environment issues. In addition, there are lots of transparency and corruption problem.

3. Theoretical Literature review

3.1 Theoretical framework

Stakeholders refer to any individual and group who can either affect or be affected by the firm. Stakeholder theory breaks through the traditional view of the shareholders' wealth maximization but firm needs to balance the interest of all stakeholders. Stakeholder theory proposes that the firm development is a result from all stakeholder interests (Freeman, 1984). This theory concerns with the firms' value, which is not only related to the shareholders' wealth, but the firms should also create their value to the stakeholders (Freeman, 1984). Stakeholders include both internal and external: such as customers, suppliers, firm's staffs, shareholders, business organisations, social communities and environmental situation. Firm needs to understand and satisfy these parties as much as possible because the inclusion of stakeholders' interest in firm policy decision making is not only ethical imperative but also increasing competitiveness. In addition, Freeman (1984) claims that building the stakeholders' satisfactory would reduce the direct and indirect costs, leading to success of long-term firms' objectives.

3.2 Empirical literature review and hypothesis development

Empirical evidence suggests ESG performance can be influenced by both country- specific and firm-specific factors. Country-specific factors include economic growth, legal system, corruption, and economic inequality. Firm-specific factors include firm size, financial risk, profitability, and cash flows.

3.2.1 Country-specific factors

Economic growth refers to an increase in a country's gross national product or when the productivity of that country increases. Diaye et al. (2022) studied the impact of economic growth onESG performance using 29 OECD countries between1996 and2014. They foundthat there is positiverelationship in long-terrm Ho et al. (2019) found astatistically relationship between ESG performance and economic growth although this relationship is variedby country income group . Yousefian et al. (2023) reveal that economic growth is positively impact on firm social responsibility of firms in European countries .Skare and Golja (2014) suggest that the government should encourage firms to focus on social responsibility because this can raise economic growth for a nation.

Legal system can be divided into2 main forms, civil law systems and common law systems. Common law country employs the form of published judicial opinions whereas the civil law systems use the codified statutes predominate. La Porta et al (2008) that the c argueommon law system is more discretionary and has better shareholder protection compared to thecivil law system. Liang and Renneboog (2017) found that the legal system used by the country is correlated withESG performance. Countries that use common law systems have ESG performance compared to countries that use civil law system. This is in line with a study byCastillo-Merio and Rodrigues-Perez (2021) who investigates factors affecting the sustainable performanceof firms in financial 64 industry incountries between 2002and 2018. However, Chih et al (2010) argue thatthe impact of legal system may be the result of bias from internal factorswithin the firm.

Corruption is a problem in every country, especially developing countries. Hossain and Kryzanowski (2021) study the relationship between political corruption and corporate social responsibility disclosure in the United States and show a positive relationship. Hoang (2022) studies the impact of corruption and carbon risks on environmental report disclosure in the U.S. and shows that political corruption influence environmental disclosure. Khalid et al. (2022) present that low corruption level can be result to the firms' good govereance. In addition, Khoury et al. (2023) show that corruption level positively impacts on ESG score in MENA region.
Economic inequality is inequality in the distribution of income. This is due to inequality in 3 aspects— inequality in income and property, inequality in consumption, and inequality in production decisions. Economic inequality is phenomenon in a capitalist economy, in which private individuals own the factors of production and have the power to make economic decisions. Chen et al. (2019) studyicy in Taiwaninequality reduction pol and reveal that promoting corporate social responsibilitycan help in reducing inequality. Semet (2020) studied inequality in OECD stating that inequality affects borrowing costs as a result of social issues such as health, gender, and education. Huang et al. (2022) reveals that reducing inequality can create sustainability for communities.
Subsequently, the hypothesis1-4 can be identified as follows:

Hypothesis 1: Economic growth has a positive impact on ESG performance.

Hypothesis 2: Legal system has an impact on ESG performance.

Hypothesis 3: The level of corruption has a negatively impact on ESG performance.

Hypothesis 4: Economic inequality has negatively impact ESG performance.

3.2.2 Firm-specific factors

There are several firm-specific factors that affect ESG performance. Hossain and Reaz (2007) studied ESG disclosure of financial firms in India. They found that size and asset are positively related on ESG disclosure. Hasnan et al. (2020) studied the firm characteristics affecting good corporate governance of listed companies in Malaysia during 2011-2016. They show that financial performance is positively influence good governance. Rahman and Alsayegy (2021) study factors affecting ESG disclosure Asia between 2005 and 2017 suggesting that profitability, size is positively related to ESG disclosure and firm liabilities is negatively impact on ESG disclosure. Izcan and Bektas (2022) found the relationship between corporate risks and ESG performance in European banks. Khoury et al. (2023) study the factors affecting ESG performance of financial firms in MENA. They show that size and profitability is positively impact on ESG Score.

Subsequently, the hypothesis5-8 can be identified as follows:

Hypothesis 5: Firm size is impact on ESG performance.

Hypothesis 6: Financial risk is impact on ESG performance.

Hypothesis 7: Profitability is impact on ESG performance.

Hypothesis 8: Free cash flows is impact on ESG performance.

4. Research designs

4.1 Data

This study uses listed firms in 20 emerging markets during 2013-2022. Emerging markets are based on IMF classification, including Argentina, Brazil, Chile, China, Colombia, Egypt, Hungary, India, Indonesia, Iran, Malaysia, Mexico, Philippines, Poland, Russia, Saudi Arabia, South Africa, Thailand, Turkey and the United Arab Emirates. The annual data were collected from S&P Capital IQ Pro and World Bank Database.

4.2 Model and variable definitions

Given that this study employs panel data, this study uses pooled OLS regression controlling form year- and country-fixed effect. The empirical model to investigate the factors influence ESG performance as specified in Equation (1) and measurement of variables are explained in Table 1

$$\mathrm{ESG}_{i,t} = \beta_0 + \beta_1 \mathrm{Growth}_{i,t} + \beta_2 \mathrm{Legal}_{i,t} + \beta_3 \mathrm{Corrupt}_{i,t} + \beta_4 \mathrm{Ineq}_{i,t} + \beta_5 \mathrm{Size}_{i,t} + \beta_6 \mathrm{Risk}_{i,t} + \beta_7 \mathrm{Profit}_{i,t} + \beta_8 \mathrm{FCF}_{i,t} + \mathrm{YearFixed\ Effect}_t + \mathrm{CountryFixed\ Effect}_t + \varepsilon_{it} \quad (1)$$

Table1 Variable definitions

Variable	Measurement
Dependent variable	
ESG Performance (ESG)	ESG Score Data are provided from S&P Capital IQ Pro
Independent variables	
Economic Growth (Growth)	GDP growth Data are provided from World Bank Database
Legal system (Legal)	Dummy variable, equal to 0 when a country use common law system, otherwise=1
Corruption (Corrupt)	Corruption score Data are provided from World Bank Database
Inequality (Ineq)	Gini coefficient Data are provided from World Bank Database
Firm Size (Size)	Natural logarithm of market value Data are provided from S&P Capital IQ Pro
Financial Risk (Risk)	Debt-to-equity ratio Data are provided from S&P Capital IQ Pro
Profitability (Profit)	Return on equity ratio (ROE) Data are provided from S&P Capital IQ Pro
Free Cash Flows (FCF)	Free cash flows-to-asset ratio Data are provided from S&P Capital IQ Pro

5. Results and discussion

During the study period there are 13,815 listed firms. However, only 3,174 firms have information on ESG performance. Table2 presents average ESG performance for each emerging market from 2013-2022 which has been increase over time suggesting that firms put more attention on this issue.

Table 2 Average ESG performance in emerging markets 2013-2022

Country	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Argentina	NA	NA	58.10	24.16	22.86	32.27	35.14	38.42	40.43	41.56
Brazil	52.06	50.53	51.48	50.46	50.94	51.84	51.32	49.20	50.47	50.69
Chile	34.30	37.72	38.21	43.94	39.03	42.28	46.42	48.50	53.04	55.43

China	26.94	28.28	30.16	35.82	30.85	31.82	31.27	33.42	36.80	40.97
Colombia	39.38	41.99	41.50	53.49	52.42	51.91	53.84	55.23	57.57	58.02
Egypt	20.47	20.67	21.93	26.06	24.46	25.88	29.10	27.26	30.00	30.72
Hungary	55.61	54.25	56.37	58.41	58.68	54.87	57.20	46.38	53.37	57.03
India	46.12	46.60	47.81	48.74	50.78	51.81	50.85	52.34	53.49	40.92
Indonesia	45.02	43.17	42.75	44.30	46.90	48.03	48.66	50.47	50.45	50.83
Malaysia	36.91	38.31	41.29	45.67	48.63	50.98	53.88	54.03	44.53	42.02
Mexico	41.90	41.28	40.51	41.59	43.37	43.66	45.00	47.58	49.03	47.58
Philippines	34.73	33.76	35.16	38.62	40.26	41.44	46.49	49.73	50.60	51.94
Poland	33.10	35.15	35.27	39.12	42.02	44.54	47.65	48.56	52.00	53.67
Russia	33.98	35.56	38.88	38.71	41.68	44.79	45.63	47.96	49.04	52.78
Saudi Arabia	26.65	27.40	23.05	23.68	26.55	30.54	31.56	34.33	33.61	34.19
South Africa	45.36	45.79	47.10	48.33	48.57	49.44	50.65	50.96	52.92	52.95
Thailand	47.12	49.21	51.59	54.15	53.51	57.65	53.50	50.47	50.48	52.36
Turkey	43.80	44.31	48.23	52.47	52.98	53.60	54.03	56.57	60.91	62.98
UAE	33.92	23.50	35.73	34.36	34.90	35.49	36.75	41.20	38.60	36.06
	38.74	**38.75**	**41.32**	**42.21**	**42.60**	**44.36**	**45.73**	**46.45**	**47.76**	**48.04**

Table 3 shows descriptive statistics (panel a) and correlation matrix (panel b). ESG performance has average of 43.10. Average natural logarithm of size is 21.16. Average financial risk which measured by debt-to-equity ratio is 1.40 times. Average return on equity is 0.1383 and average free cash flows-to-asset is 0.0363. The average growth rate is 4.5% per annum. Average dummy variable for legal system is 0.39 suggesting most firms are located in civil law countries. Average equality index is 36.36. Lastly, average control corruption index is -0.19. The negative number of control corruption index suggests that perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption in the sample is below the world average.

Table 3 Descriptive statistics and correlation matrix

Panel a : Descriptive statistics

	$\bar{x}$	**S.D.**	**Min**	**Max**
ESG	43.0991	19.80	0.6062	94.2135
Size	21.1628	1.72	13.9032	28.3669
Risk	1.4023	30.07	0.0000	4502.8760
Profit	0.1383	0.34	-18.8046	10.9963
FCF	0.0363	0.09	-2.9937	1.2967
Growth	4.5040	3.71	-9.9432	11.7374
Legal	0.3894	0.49	0.0000	1.0000
Ineq	39.3580	5.14	26.0000	63.0000
Corrupt	-0.1853	0.39	-1.0204	1.4990

Panel b : Correlation matrix

	ESG	**Size**	**Risk**	**Profit**	**FCF**	**Growth**	**Legal**	**Ineq**	**Corrupt**
ESG	1								
Size	0.226	1							
Risk	0.024	-0.008	1						
Profit	0.054	0.063	-0.085	1					
FCF	0.079	0.082	-0.031	0.186	1				
Growth	-0.104	0.137	-0.005	0.038	-0.068	1			
Legal	0.036	-0.238	-0.002	0.022	0.063	0.098	1		

Ineq	0.103	-0.024	-0.004	-0.012	-0.030	-0.378	-0.345	1	
Corrupt	-0.056	-0.154	-0.011	-0.022	-0.005	-0.069	0.243	-0.127	1

Table 4 presents results on determinants of ESG performance. Results suggest that both country- and firm-specific factors influence ESG performance. For country-specific factor, economic growth are negatively statistically impact ESG performance. This result is different to results from Diaye et al. (2022) and Yousefian et al (2023) who show a positive relationship. Nevertheless, as Ho et al. (2019) suggest that relationship on economic growth and ESG performance also depends on income classification. Emerging market is a country on the transition period. Experiencing high growth may cause the firm focusing more on their productivity and ESG performance can be neglectable. In addition, the results show that firms located in common law countries have higher level of ESG performance than firms located in civil law country. This is because common law country is based on norm and tradition. Therefore, it places more emphasis on stakeholders than interpretation of law.

For firm-specific factor, firm size and firm financial risk are statistically positively impact ESG performance. This is due to the large firm and a firm with high financial risk have large amount of stakeholders involved. As a result, there is high pressure from external which require the more attention on environmental performance. The results of the study are in line with several studies, such as, Hossain and Reaz (2007), Rahman and Alsayegy (2021), Izcan and Bektas (2022), and Khoury et al. (2023).

Table 4 Determinants of ESG performance

	Model 1	**Model 2**	**Model 3**	**Model 4**
Growth	-1.65***	-2.22***	-0.338**	-0.342*
	(-16.46)	(-15.19)	(-2.51)	(-1.67)
Legal	10.5***	11.2***	26***	11.9*
	(12.57)	(13.3)	(4.68)	(1.92)
Ineq	0.378***	0.288***	-0.881***	0.201
	(7.25)	(5.04)	(-2.61)	(0.5)
Corrupt	0.86	2.33**	-3.14	2.69
	(0.97)	(2.57)	(-0.7)	(0.57)
LnSize	3.26***	3.8***	4.97***	5.19***
	(14.31)	(16.34)	(21.77)	(22.44)
Risk	0.307**	0.342***	0.328**	0.331***
	(2.41)	(2.79)	(2.45)	(2.63)
Profit	1.76**	1.17	0.245	-0.00905
	(2.07)	(1.31)	(0.24)	(-0.01)
FCF	12.7***	12.3***	4.98	3.91
	(3.09)	(3.08)	(1.24)	(0.98)
C	-40.6***	-34.6***	353***	190**
	(-7.33)	(-2.96)	(4.49)	(2.26)
Fixed Year		Y		Y
Fixed Country			Y	Y
R^2	0.148	0.18	0.293	0.307

Since emerging markets are located on different region and the results can be different due to cultural characteristics. Subsequently, this study explores results of determinants of ESG performance classified by region. Table 5 present the results of ESG performance determinants classified by region. Results reveal that country-specific factors have no impact on ESG performance when specific region are investigated. determinants of ESG performance are slightly different to region. Size and free cash flows are positively statistically impact on ESG performance in Asia. Firm size, firm risk and profitability are positively statistically impact on ESG performance in Europe and South America. Nonetheless, profitability only a factor negatively influences ESG performance in Africa.

Table 5 Determinants of ESG performance by region

	ASIA	Africa	Europe	South America
Growth	0.416	-1.96	0.339	-0.684
	(0.6)	(-0.74)	(0.47)	-1.35
Legal	-12.3	(omitted)	(omitted)	(omitted)
	(-1.53)			
Ineq	-0.212	1.38	1.25	1.2
	(-0.23)	(0.98)	(1.33)	1.44
Corrupt	-1.69	(omitted)	-5.71	-25.7
	(-0.17)		(-0.35)	-1.23
LnSize	4.82***	4.07	6.45***	5.65***
	(16.97)	(1.26)	(10.85)	12.11
Risk	0.306	-0.245	0.517***	0.281**
	(1.3)	(-0.12)	(3.15)	2.17
Profit	-3.2	-25.2**	1.54*	2.86*
	(-1.48)	(-2.7)	(1.77)	1.75
FCF	11.1**	44.1	-8.57	-7.58
	(2.09)	(0.79)	(-0.76)	-0.86
C	-121*	30.9	-297***	-47.6
	(-1.69)	(0.15)	(-4.49)	-0.45
Fixed Year		Y		Y
Fixed Country			Y	Y
R^2	0.148	0.18	0.293	0.307

6. Summary and Conclusion

This study investigates factors influencing ESG performance in emerging markets by looking at both country- and firm-specific characteristics. Results suggest that both factors have an impact on ESG performance. GDP growth and legal system are country-specific factors that influence ESG performance. Firm size and Firm risk are firm specific factors that influence ESG performance. As a result, regulator should more emphasize more on ESG matter when a country is experiencing high economic growth. A tighter regulation should be occupied to serve the situation. In addition, investors who seek for firm with high ESG performance can use these characteristics as a searching criterion. Nonetheless, the results are subjected on region.

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