

# **Influence of ESG Reporting on Corporate Governance Practices: An Analytical Examination**

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## **Abstract:**

This research paper investigates how ESG reporting standards are fundamentally transforming corporate governance, moving beyond simple disclosure to reshape leadership and accountability in business. By examining the 2018–2025 period through case studies of firms like Unilever and Patagonia, the study shows that adopting ESG reporting leads to a 20-30% rise in board diversity and also links approximately 40% of executive pay to sustainability targets. These shifts help to lower agency costs by increasing transparency and improving engagement with stakeholders. The research proposes a new Integrated ESG-Governance Framework which connects international standards, such as GRI and TCFD, to governance results through clear accountability loops. The implications of this include better risk oversight and improved access to sustainable finance, showing that more standardized accounting is needed to ensure that corporate impacts are verifiable and clear.

**Keywords:** ESG, corporate governance, sustainability, transparency, stakeholder , board diversity

## **I. INTRODUCTION**

Over the years, the expectations placed on firms have changed considerably, positioning ESG reporting as a key driver of strategic investment excellence stakeholder engagement and with 98% of investors using this non-financial disclosure in decision making. The shift from voluntary to mandatory ESG reporting, which was caused by societal pressure and regulations like the CSRD, has led to almost all G250 firms now publishing sustainability disclosures. ESG reporting has become an institutionalized practice to meet emergent investor and stakeholder information needs about corporate activities' economic, environmental, and social impacts. This institutionalization of ESG reporting is driven by standard-setters, such as the Global Reporting Initiative (GRI), and the shift towards mandatory disclosure regimes, exemplified by the European Union's Corporate Sustainability Reporting Directive (CSRD) in 2022. Consequently, ESG reporting is widespread, with 96% of G250 and 79% of N100 companies currently reporting on these matters. However, there is a research gap concerning the status of utilities, worldwide scope or the influence of corporate governance mechanisms on ESG disclosure as under-investigated fields in ESG reporting. Because utilities generate vital services but also have major environmental impacts, ESG reporting is crucial for proving alignment with societal expectations and managing the sector's conflicting economic, social, and ecological demands.

This paper deepens understanding of ESG disclosure in the utilities sector by examining key factors that explain differences in reporting. It focuses on how corporate governance mechanisms such the board of directors which Is the primary internal governance body influence ESG disclosure, reflecting growing scholarly emphasis on governance systems that address societal expectations around sustainability. To achieve research objects, data has been

collected from Refinitiv Eikon, the sample of 265 worldwide utility organizations, the 2011–2019 period, the resulting 1750 observations, or the estimation of Tobit regressions to test the association between five corporate governance attributes and ESG disclosure scores. The contributions outlined in this paper extend ESG disclosure research in environmentally sensitive utilities, providing novel evidence on how key internal corporate governance mechanisms affect disclosure levels while moving beyond prior country-based and energy sub-sector studies. It further contributes by offering novel empirical evidence on how key internal corporate governance mechanisms shape the extent and quality of ESG disclosure among utilities firms. (Nicolo et al., 2023c).

It shows that larger size of boards and greater female representation boosts both ESG reporting as well as profitability, whereas independent directors don't make a clear difference. Using a two-stage structural equation model (TSSEM), the study finds a strong link between better ESG disclosure and stronger financial performance. Overall, it finds that companies with solid governance structures are more likely to report ESG information thoroughly. These findings can provide guidance to help firms and policymakers strengthen transparency, accountability, and can create value in the long term. (Brogi & Lagasio, 2025). ESG investing uses powerful investors to create change and recognize that long-term financial performance is connected to environmental and societal impact caused by a firm. This major shift caused global ESG-driven assets to triple to \$40.5 trillion between 2012 and 2020 which is almost as much as half of the world's managed assets. Regulatory standardization is advancing as the IFRS Foundation announced the creation of the International Sustainability Standards Board (ISSB) at COP26 to govern sustainability reporting. This focus on the standardization and adoption of ESG reporting among all businesses is central to our current work examining "The Influence of ESG Reporting on Corporate Governance Practices. (O'Hearn et al., 2022). Figure.1 highlights the main components of ESG- Environment, Social and Governance factors.

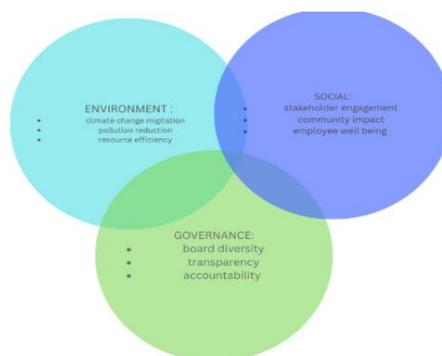


Figure 1: Components of ESG – redo diagram

Growing social and ecological pressures have caused firms to increase their ESG engagement. This study expands on prior research by examining how public governance and corporate governance interact to shape ESG behaviour of firms. The research shows that stronger public governance (which is determined by voice and accountability, political stability, government effectiveness, quality of regulation imposed, laws and control over corruption) encourages more ESG engagement. However, corporate governance and public governance act as substitutes as when public institutions are strong, internal governance becomes less important for encouraging ESG efforts from firms. (Kuzey et al., 2023). Sustainable development has become a priority for listed companies since expectations around environmental and social

responsibility have grown. Firms now adopt ESG practices so they can balance their commercial goals with ethical and societal ones, and research shows that strong ESG performance and transparent reporting build trust, enhance firm reputation, attract capital, and reduce information gaps. (Bamahros et al., 2022) This study explores how a common global framework for ESG reporting can be created by including insights from practitioners, academics, and ESG-focused organizations. Responding to the urgent need for high-quality, internationally accepted sustainability standards, the study proposes a roadmap for building the technical foundation of such standards. (Zaid & Issa, 2023).

There is an active debate among academics and practitioners about how much governance structures really shape sustainability efforts as researchers point to board composition, oversight, and institutional pressures as drivers of ESG outcomes, while many practitioners wonder whether these structures create impact or just add another layer of compliance. This study aims to bridge that gap by outlining a practical process for combining sustainability and corporate strategy through an “integrated” ESG governance framework that helps firms navigate and manage these pressures more effectively.

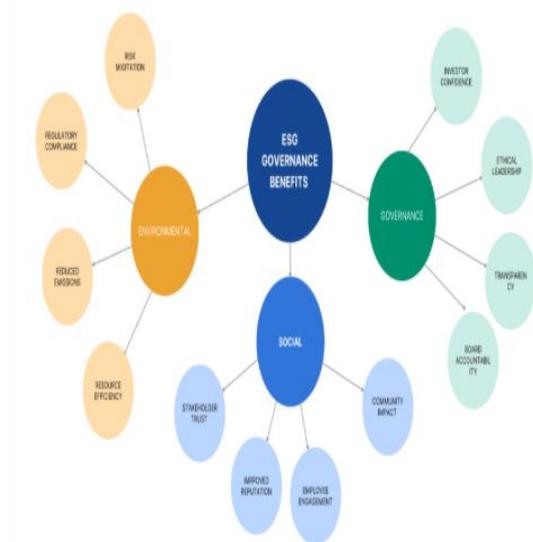


Figure 2: Benefits of each component of ESG reporting

Board size, female representation, and independent directors are key governance attributes often linked to ESG transparency. Larger boards and greater independence typically enhance oversight, while female representation is associated with stronger stakeholder orientation which together promote higher levels of ESG disclosure. The term ESG gained prominence after the UNPRI initiative and has rapidly expanded as a global investment strategy, with ESG-integrated assets reaching \$17.5 trillion. Investors and stakeholders now demand transparency in both financial and material ESG information, pushing companies to integrate ESG into their operations. Although global research on ESG has grown, studies on India remain limited despite its corporate sector’s competitiveness and lagging environmental and social performance. Government initiatives like the NVG-SEE have encouraged greater sustainability focus. This study examines how key corporate attributes like profitability, market performance, risk, and foreign institutional ownership drive ESG disclosure among Indian listed firms. (Sharma et al., 2020)

Board independence, gender diversity, and meeting frequency show a positive and significant effect on governance, environmental, and ethics disclosures. Board size is positively and significantly linked only to environmental reporting. (Khairiddine et al., 2020). The paper examines whether increases in ESG reporting quantity, quality, and performance are occurring, focusing on Swedish multinational firms using data from Sustainalytics, corporateregister.com, and the Alliance for Corporate Transparency. While ESG reporting quality has improved, actual ESG performance has stagnated since 2015. The authors of these websites argue that better outcomes and not more or better reporting are needed to address challenges like climate change and COVID-19. (Arvidsson & Dumay, 2021)

Analysis reveals that board size and female representation exhibit statistically significant positive correlations with both ESG disclosure and firm profitability, whereas independent directors do not show any statistically significant relationship with these outcomes. Over the past decade, many firms have voluntarily disclosed sustainability information to meet stakeholder expectations and gain advantages such as lower capital costs, better financing access, and enhanced reputation. However, voluntary reporting faces issues like inconsistent standards, selective disclosure, and low information quality. These concerns led the EU to introduce mandatory sustainability reporting through the 2014 CSR Directive, aiming to improve transparency and encourage firms to prioritize nonfinancial performance. Evidence shows mixed market reactions but some real increases in sustainability activities. (Gerwing et al., 2022)

Enhanced ESG disclosure is strongly linked to better financial outcomes, underscoring the close interplay between robust sustainability practices and overall corporate performance. ESG practices have become central to corporate decision-making as global expectations for sustainability, ethical governance, and social responsibility grow (Shalhoob, 2025). Firms should integrate ESG into core strategy by strengthening board oversight, improving quality of disclosure, and aligning practices with ethical principles such as Maqasid al-Shariah. Regulators can enhance transparency by unifying ESG standards for all firms, requiring assurance, and consistently reporting. Policymakers should support these efforts through incentives and national strategies that focus on sustainability that guide capital toward ethical and resilient corporate performance. (Padmapriya & Jayamala, 2025). This study highlights gaps in organizational and regulatory frameworks and recommends integrating governance, strengthening compliance monitoring, and increasing transparency to improve performance which enhances sustainability, and operational effectiveness.

This study aims to analytically examine the influence of Environmental, Social, and Governance (ESG) reporting on corporate governance practices. Specifically, it seeks to assess the extent to which ESG disclosures enhance board oversight and accountability mechanisms, evaluate the impact of ESG reporting on executive compensation structures and incentive alignment and investigate the role of ESG metrics in mitigating agency conflicts and improving long-term shareholder value.

The rest of this paper is structured as follows -Section 2 reviews the literature on ESG and corporate governance. Section 3 of this paper is a description of the research methodology which includes the 3 different case studies conducted to answer 3 different questions. Section 4 of this paper shows the results of the case study analysis approach and an analysis of the data

while the fifth section discusses the findings in context of \_\_\_. Finally, the last section concludes the research with limitations, implications and suggestions for research in the future.

## II. LITERATURE REVIEW

ESG reporting and corporate governance have evolved together since ESG shows governance quality as well as reshapes governance priorities. With the rise of green finance and the rise in the use of ESG scores, it has become obvious that non-financial factors are important for determining the value of a company. Research also shows that green finance supports firms' innovation efforts, while the COVID-19 period revealed how vulnerable many companies are during major shocks. Because the field is so broad and so complicated, a bibliometric method helps organize and map these developments. (Danci et al., 2025). Companies are now responsible for environmental and social impacts as well as financial performance under ESG. Even though general ESG standards exist, the tourism industry lacks industry-specific reporting tools despite its large environmental and social impact. (Ye et al., 2025). The European Union's financial system is moving toward sustainability because of regulations like the CSRD, that causes companies to include ESG factors in their financial decisions and to guide investments toward greener development. Firms now have stronger incentives to report ESG information, as it affects investor trust, regulation, and competitiveness. This shift is also making companies rethink and redesign their governance structures. However, there are still challenges, like inconsistent ESG standards, limited data, and integrating sustainability into financial strategy. (Stoicescu & Sima, 2025). As the climate crisis worsens day by day, an urgent shift toward sustainability is needed. Redesigning corporate governance to support decarbonization more can help, but this is difficult with current models that are focused on shareholder value. Although there are new ideas, structural issues like virtual corporate domiciles continue to exist. This tells us that truly effective climate action may need broader democratic approach and not traditional governance (Davis, 2025).

Corporate ESG performance has become extremely important for sustainability of the global economy. Informal parts of corporate governance, like informal hierarchies within boards, play a key role in shaping ESG outcomes. Evidence from Chinese listed firms shows that stronger informal board hierarchies are linked to better ESG performance, mostly because of better internal control, higher innovation efficiency, and stronger financial results of the company. This positive effect is even stronger in firms that have active board interaction, lower ownership concentration, and combined chairman–CEO roles (Peng & Chen, 2024). Corporate leadership and ESG performance are closely correlated, as strong board leadership can improve a firms ESG outcomes. This correlation shows the growing importance of governance structures in determining sustainable business practices (Bhat et al., 2023).



Figure 3: Collective benefits of ESG reporting and corporate governance

ESG reporting has evolved from simple disclosure into something that shapes corporate governance. Reporting standards such as GRI, Integrated Reporting, and TCFD influence board oversight, risk management, and stakeholder engagement. ESG reporting also strengthens accountability, reputation, and access to sustainable finance, which in turn improves quality of governance. However, there are challenges related to data quality, standardization, and measuring real sustainability impact, highlighting the need for improved accounting systems and clearer ESG frameworks. Social and Environmental Accounting (SEA) frameworks improve accuracy of ESG data, standardize metrics, assess impacts on stakeholders, and strengthen ESG disclosures (Chopra et al., 2024).

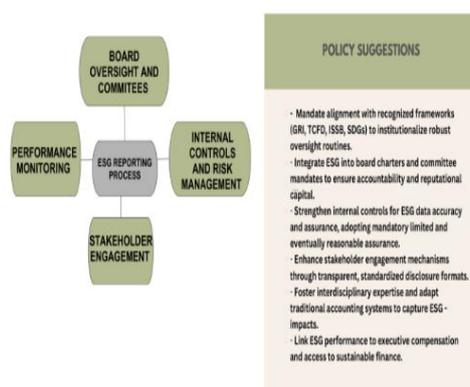


Figure 4: Composition of the reporting process and suggestions to improve this procedure

As global focus on sustainable development increases, so does the importance of ESG metrics. ESG performance influences both long-term corporate strategy of the business and investor decisions (Liang et al., 2025). As ESG factors are becoming more important for investors and for corporate accountability, there is a greater need for a clear, reliable, and standardized ESG audit. However, differences in reporting standards globally, inconsistent disclosures from firms, and weak audit frameworks reduce the reliability of existing ESG evaluations (Ilori et al., 2023). The conduction of our extensive literature review brings us to 3 research questions and hypotheses:

- How does the adoption of ESG reporting standards affect the composition and diversity of corporate boards?
- To what extent do ESG disclosures influence executive remuneration policies and performance-based incentives?
- In what ways do ESG reporting practices reduce agency costs and enhance stakeholder-oriented governance?

Hypotheses:

H1: Firms with comprehensive ESG reporting exhibit stronger board independence and diversity, leading to improved governance effectiveness.

H2: Higher ESG disclosure quality is positively associated with performance-linked executive compensation, fostering better incentive alignment

H3: Robust ESG reporting significantly mitigates agency conflicts, resulting in elevated firm valuation and reduced cost of capital.

### III. RESEARCH METHODOLOGY

This study employs a qualitative case study with theoretical underpinning approach grounded in secondary data from high-impact sources. Quantitative analysis draws on peer-reviewed articles from Scopus/Web of Science (WoS) and ABDC-listed journals (2018–2025), supplemented by statistical datasets from Harvard Business Review (HBR), Statista, McKinsey, and Deloitte reports on ESG benchmarks and governance and insights derive from in-depth case studies of exemplar companies help curate a robust research methodology.

**RQ 1:** How does the adoption of ESG reporting standards affect the composition and diversity of corporate boards?

1) Impact of ESG Reporting Adoption on Board Composition and Diversity:

a. Case Context and Rationale

The text explores how environmental, social, and governance (ESG) reporting mandates fundamentally reshape corporate board structures across different regulatory landscapes. By comparing the European Union's mandatory disclosure framework with the voluntary regime in Saudi Arabia, the research highlights how diverse legal pressures influence organizational accountability.

b. Institutional Background

In the European Union, strict transparency rules encourage companies to diversify their leadership teams to preserve institutional legitimacy and maintain stakeholder confidence. By contrast, firms in Saudi Arabia rely on sustainability reporting mainly as a strategic signal to appeal to international investors, even though there is no formal legal requirement to do so. Overall, the study explores how differences in regulatory pressure shape changes in corporate governance across both developed and emerging markets. This discussion helps explain how non-financial reporting can act as a driver of board-level modernization on a global scale. (Buchetti et al., 2024). Observed Changes in Board Composition

1 .Gender Diversity

The use of ESG reporting standards allows firms to signal stronger commitments to social inclusion and ethical governance, particularly through higher levels of female representation on corporate boards. This change is governed by two different institutional settings:

- Mandatory disclosure (EU): Under regulatory frameworks such as the NFRD and CSRD, gender diversity has become more formally embedded in governance systems. These rules make diversity indicators more transparent and comparable, which strengthens accountability and helps align firms with stakeholder expectations.
- Voluntary signalling (Saudi Arabia): Where there is no legal requirement, companies use ESG disclosure as a way to demonstrate credibility and long-term commitment to sustainability to international investors, often in line with national programs such as Vision 2030.

Overall, whether driven by regulation or reputational pressures, ESG reporting contributes to faster changes in governance structures toward greater board diversity.

2. Board Independence

The introduction of mandatory ESG reporting rules increases the need for independent directors to act as neutral overseers of sustainability practices, which helps improve the reliability of disclosures and reduces the risk of purely symbolic or self-serving reporting. In regulated regions such as the European Union, this change is driven by the need to maintain

institutional legitimacy and comply with stronger accountability requirements, including those set out in the NFRD and CSRD. In contrast, in more voluntary settings like Saudi Arabia, appointing independent directors mainly serves as a strategic signal to global investors and sustainability benchmarks, helping to demonstrate the firm's governance quality and long-term credibility. Overall, across different regulatory systems, ESG adoption is associated with higher levels of board independence as companies adjust governance structures to meet global stakeholder expectations and sustainability standards. (Jing et al., 2025)

### 3. Board Expertise and Committee Structures

The move toward ESG reporting standards has led many companies to formally set up sustainability committees at the board level, reflecting a shift from a narrow focus on financial oversight to a broader approach to stakeholder-based governance. To remain compliant and maintain legitimacy under mandatory disclosure systems such as the EU's NFRD and CSRD, these committees increasingly include directors with specific knowledge of environmental issues and regulatory requirements to meet higher accountability expectations. In more voluntary environments such as Saudi Arabia, the creation of these committees also acts as an important signalling mechanism for international investors and national initiatives like Vision 2030. This helps demonstrate the firm's long-term commitment to sustainability and strengthens its overall governance credibility.

### 4. Governance Mechanisms and Strategic Implications

The use of ESG reporting standards has changed the role of company boards from being mainly focused on monitoring to taking on a more active role in integrating sustainability into business strategy. Having a more diverse board brings in different perspectives, which can improve decisions related to climate risks, social issues, and ethical behaviour. This supports stakeholder theory, which argues that firms should balance the interests of shareholders with those of employees, communities, and regulators.

In more strictly regulated regions such as the European Union, ESG reporting works as a formal pressure that directly influences board diversity. The introduction of the European Union's Corporate Sustainability Reporting Directive (EU CSRD) in January 2023 expanded earlier non-financial reporting rules by requiring a much larger number of companies to follow mandatory ESG standards. In contrast, in countries like Saudi Arabia where ESG reporting is more voluntary, adoption is mainly driven by reputational concerns and market expectations, which can indirectly affect board composition. (Alotaibi & Al-Dubai, 2024)

#### **Key Insights from the Case Study:**

- ESG reporting adoption is associated with greater gender diversity and board independence.
- Mandatory disclosure regimes exert a stronger and faster influence on board composition than voluntary frameworks.
- ESG standards encourage the formation of specialized board committees and the inclusion of sustainability expertise.
- Board diversity enhances ESG performance credibility, even when financial performance effects remain ambiguous.

#### **Contribution to Research Question**

This case study shows adopting ESG reporting standards materially affects corporate board composition by promoting diversity, independence, and sustainability-oriented expertise. The effect is strongest in jurisdictions with mandatory ESG regulation but is increasingly

observable in emerging markets where ESG adoption is driven by strategic legitimacy rather than legal enforcement.

**RQ 2:** To what extent do ESG disclosures influence executive remuneration policies and performance-based incentives?

### 1. Case Background and Motivation:

As environmental and social pressures continue to grow worldwide, corporate performance on environmental, social, and governance (ESG) issues has become an increasingly important measure of firm value, credibility, and long-term viability. ESG reporting, in particular, has shifted from being mainly a voluntary reputational tool to a more strategic element of corporate governance that affects how managers are evaluated and held accountable. Executive pay, which has traditionally been based on financial metrics such as profits, share price performance, and revenue growth, is now being reassessed in response to rising stakeholder demands and closer regulatory attention. This case study explores the ways in which ESG disclosure affects executive compensation structures and performance-related incentives, using evidence from China's A-share listed companies between 2012 and 2021, along with supporting insights from developed economies and the asset and wealth management (AWM) industry. The discussion places executive remuneration within wider changes in corporate governance, emphasizing ESG disclosure as a factor that reshapes managerial priorities beyond a narrow focus on short-term shareholder returns

### 2. Institutional Context: ESG Disclosure and Governance Logic

Executive compensation is a key internal governance mechanism used to align managers' actions with firm goals. Traditional agency theory focuses on maximizing shareholder value and argues that adding non-financial objectives can weaken incentives and increase the risk of managers acting in their own interests. From this view, linking pay to ESG measures may create inefficiencies or simply redistribute value across different stakeholder groups. However, stakeholder theory and more recent governance approaches take a different position. They suggest that integrating ESG considerations can improve a firm's long-term stability, reduce exposure to downside risks, and strengthen its reputation. ESG disclosure plays an important role in this shift by turning sustainability from a broad commitment into something that can be measured and monitored. As ESG ratings become more relevant for investors, regulators, and capital markets, companies face increasing pressure to connect executive pay more closely to their reported ESG performance.

### 3. Case Evidence: ESG Disclosure and Executive Compensation in China

China offers a unique and analytically valuable context for studying the governance effects of ESG disclosure. In contrast to more developed markets, ESG practices in China are influenced not only by market dynamics but also by substantial government involvement. Drawing on ten years of data from A-share listed companies, recent empirical research finds a clear positive association between ESG performance and the level of executive compensation. Results show that ESG reporting affects executive pay through both direct and indirect channels. Companies with higher ESG scores are more likely to provide greater compensation to senior executives, indicating that sustainability performance is treated as a strategic priority. In addition, financial performance plays a key intermediary role. Strong ESG outcomes are associated with better financial results, which then support higher levels of executive remuneration. Overall, this implies that ESG disclosure goes beyond simply reallocating

resources and can help generate additional firm value when it is effectively embedded within corporate governance practices. (Yang et al., 2025).

#### 4. Heterogeneity in ESG–Compensation Sensitivity

The effect of ESG disclosure on executive pay is not consistent across all firms. Evidence from the case indicates substantial variation depending on both a firm’s environmental risk profile and its governance arrangements. To begin with, companies operating in pollution-intensive industries show a stronger relationship between ESG performance and executive remuneration. In these sectors, ESG reporting carries greater regulatory and reputational weight, which increases the importance of sustainability outcomes in managerial assessments and incentive design. In addition, corporate governance structures significantly shape this relationship. Firms that separate the roles of general manager and board chair tend to exhibit a more pronounced link between ESG outcomes and executive compensation. This division of authority strengthens board independence and oversight, limiting the scope for purely symbolic ESG practices and increasing the credibility and effectiveness of ESG-based incentive mechanisms (Ding et al., 2025).

#### 5. Comparative Insights: Developed Markets and the AWM Sector

Evidence from developed economies, particularly within the asset and wealth management sector, further demonstrates the role of ESG disclosure in shaping executive compensation practices. An increasing number of firms have begun to integrate ESG-related key performance indicators (KPIs) into executive incentive schemes. These measures are most embedded in short-term bonus plans and, to a lesser extent, in long-term incentive arrangements. Nevertheless, ESG-linked pay frameworks remain inconsistent and largely discretionary. In most firms, ESG KPIs are applied primarily to board members and senior executives, with greater emphasis placed on environmental metrics than on social or governance factors. In addition, firms frequently rely on qualitative evaluations, reflecting the lack of standardized ESG measurement systems. This absence of uniform frameworks complicates the setting of performance targets, the verification of outcomes, and the overall credibility of ESG-based incentives. Despite these constraints, the rapid expansion of ESG-related assets under management, together with increasing scrutiny from regulators, investors, and beneficiaries, indicates that ESG disclosure is likely to become more formally embedded within executive remuneration structures. In contexts where market-driven coordination proves insufficient, regulatory intervention may play a growing role in standardizing ESG-linked compensation practices (PwC, 2024).

#### 6. Governance Implications and Strategic Outcomes

This case study identifies ESG disclosure as an important driver in the reshaping of executive incentive frameworks. By increasing the transparency and comparability of sustainability performance, ESG reporting allows boards to incorporate non-financial objectives into remuneration contracts while maintaining a focus on financial accountability. When supported by effective governance structures, ESG-linked compensation can promote long-term value creation, strengthen risk management, and enhance stakeholder confidence. At the same time, the impact of ESG-based incentives is highly context-dependent. Their effectiveness varies according to institutional environments, industry exposure, and internal governance arrangements. In emerging economies such as China, ESG-linked pay structures tend to reflect a blended rationale, influenced by both regulatory legitimacy and market-based

signalling. In contrast, in developed markets, these practices are more strongly shaped by investor expectations and reputational considerations.

**RQ 3:** In what ways do ESG reporting practices reduce agency costs and enhance stakeholder-oriented governance?

This case provides evidence that ESG disclosure has a meaningful and quantifiable impact on executive remuneration policies and performance-based incentive systems. ESG reporting influences not only the level of executive pay, but also its design, responsiveness to performance, and underlying governance logic. The results indicate that ESG-linked compensation mechanisms are most effective when anchored in credible disclosure practices, strong board monitoring, and performance benchmarks tailored to sector-specific conditions. The analysis contributes to the corporate governance literature by identifying executive remuneration as a key micro-level channel through which ESG disclosure shapes organizational conduct. It also points to important directions for future research, including the structure and weighting of ESG-based incentives, their integration into long-term pay schemes, and their effects across different institutional and regulatory contexts. From a practical and policy perspective, the findings emphasize the need to embed ESG considerations into remuneration frameworks in a way that preserves financial rigor while advancing sustainability objectives. Doing so can help align executive incentives with the broader aims of responsible management and long-term corporate resilience (Gregory, 2025).

## **1. ESG Reporting as a Governance Mechanism: Agency Cost Reduction and Stakeholder Alignment in Chinese Firms**

As environmental, social, and governance (ESG) factors play an increasingly prominent role in shaping corporate strategy and capital market dynamics, ESG reporting has shifted from a primarily disclosure-oriented practice to a more substantive element of corporate governance. This shift raises a central governance issue: whether ESG reporting helps to reduce agency problems within firms or whether it may, instead, intensify them by redirecting managerial focus away from the maximization of shareholder value. Within agency theory, firms are understood as contractual arrangements characterized by conflicts between principals and agents (Type I agency conflicts) and, particularly in emerging market contexts, between controlling and minority shareholders (Type II agency conflicts). ESG reporting interacts with these governance challenges by affecting information asymmetries, managerial decision-making autonomy, capital allocation processes, and the firm's engagement with external stakeholders. This case study investigates the extent to which ESG reporting contributes to the reduction of agency costs and supports a more stakeholder-oriented governance framework, drawing on large-scale empirical evidence from Chinese listed companies and situating the analysis within agency theory, stakeholder theory, and signalling theory.

## **2. Institutional Setting: China as a Governance Laboratory**

China offers a particularly valuable institutional setting for examining the relationship between ESG reporting and agency costs. The corporate environment is characterized by high ownership concentration, a substantial role of state-owned enterprises (SOEs), significant government involvement, and rapidly developing market institutions. Within this context, ESG-related activities are influenced not only by market incentives but also by regulatory pressures, political considerations, and broader social policy objectives. Drawing on a large

sample of 2,277 Chinese listed firms over the period 2009 to 2024, the evidence analysed in this case enables a direct evaluation of how ESG practices—especially when systematically disclosed through formal ESG reporting—affect both Type I (principal–agent) and Type II (principal–principal) agency costs across different governance structures.

### **3. ESG Reporting and the Reduction of Type I Agency Costs**

Type I agency costs stem from conflicts between shareholders and managers and commonly appear in the form of excessive private benefits, inefficient investment decisions, earnings management, and suboptimal use of corporate cash flows. ESG reporting can help alleviate these conflicts through several complementary channels. First, ESG disclosure functions as a form of commitment mechanism. By publicly reporting environmental and social initiatives, firms limit managerial flexibility over discretionary resources. Consistent with signalling theory (Spence, 2002), the undertaking and disclosure of costly ESG activities serve as credible signals of stronger governance standards and higher firm quality. This form of reputational commitment constrains managerial opportunism by linking resources to externally visible projects, thereby reducing monitoring and bonding costs. Second, firm-level evidence from China indicates that social-related ESG activities are particularly effective in lowering Type I agency costs. Initiatives such as employee welfare programs, community engagement, and workforce stability closely align with government priorities. This alignment helps reduce regulatory frictions, improve access to external financing, and lower compliance risks, which in turn indirectly disciplines managerial behaviour and enhances operational efficiency. Third, ESG reporting enhances informational transparency, thereby reducing information asymmetries between managers and shareholders. Higher-quality disclosure enables boards and investors to more effectively evaluate managerial decisions, strengthening internal oversight and limiting self-interested conduct. The documented decline in management expense ratios among firms with stronger ESG performance supports the view that ESG reporting contributes to improved internal governance efficiency (Gregory, 2025b).

### **4. ESG Reporting and the Mitigation of Type II Agency Costs**

Type II agency costs, which arise from conflicts between controlling shareholders and minority investors, are especially pronounced in China due to high ownership concentration and the significant role of the state. ESG reporting can help mitigate these conflicts through several channels. First, governance-focused ESG disclosures strengthen board accountability and reduce the capacity of controlling shareholders to appropriate private benefits. Greater transparency in governance practices enhances protections for minority shareholders and increases external oversight, thereby limiting tunnelling behaviour, related-party transactions, and the risk of expropriation. Second, ESG reporting supports the formation of broader stakeholder coalitions, in line with Freeman's stakeholder theory. By formally acknowledging the interests of employees, creditors, regulators, and customers, firms signal a commitment to cooperative governance rather than narrowly extractive control. This helps reduce relational tensions and supports more stable long-term contracting, redirecting firm resources away from agency-driven inefficiencies and toward productive investment. Third, empirical evidence indicates that firms with stronger ESG performance—particularly in governance and social dimensions—experience lower Type II agency costs. This effect is most pronounced among firms with weaker baseline governance frameworks, suggesting that ESG practices can partially substitute for underdeveloped formal institutional protections in emerging market settings

## **5. ESG Reporting as Stakeholder-Oriented Governance**

Beyond its role in reducing agency costs, ESG reporting also reshapes corporate governance by embedding a more stakeholder-oriented perspective into corporate decision-making. Rather than acting as a constraint on profitability, the evidence from China indicates that ESG disclosure strengthens stakeholder confidence, reputational standing, and institutional legitimacy, all of which contribute to enhanced firm performance. More specifically, environmental disclosures help lower regulatory uncertainty and compliance-related costs. Social disclosures support improved labour relations, stronger brand reputation, and greater access to favourable government relationships. Governance disclosures reinforce oversight structures and strengthen investor trust. Collectively, these mechanisms support a governance framework in which value creation is distributed across multiple stakeholder groups, rather than being disproportionately captured by insiders. Importantly, this stakeholder-oriented governance model does not come at the expense of financial outcomes. Empirical findings show that stronger ESG ratings are associated with higher returns on assets (ROA), particularly in firms with lower agency costs. This pattern supports the interpretation that ESG reporting improves performance through governance enhancements, rather than despite them.

## **6. Reconciling Competing Views on ESG and Agency Costs**

This case study also engages with critiques advanced by Cornell and Damodaran (2020), who contend that ESG lacks clear conceptual foundations and may weaken shareholder accountability. The evidence from China suggests that although challenges in measurement and definition remain, institutional context plays a critical role. In settings where certain ESG activities function in a quasi “tax-like” manner due to government influence such as employment absorption by state-owned enterprises, ESG disclosure operates as a stronger signal of firm commitment and governance discipline. Furthermore, the findings are consistent with the interpretation that shareholder preferences may be multi-dimensional rather than narrowly financial. In this view, investors may place value on social stability, regulatory compliance, and long-term organizational resilience alongside traditional return-based objectives. ESG reporting therefore appears to align managerial behaviour more closely with the broader objectives of principals, rather than diverting attention away from shareholder interests.

This case study demonstrates that ESG reporting practices reduce agency costs and enhance stakeholder-oriented governance through:

- Constraining managerial discretion and reducing free cash flow misuse (Type I agency costs).
- Improving transparency and oversight, limiting expropriation by controlling shareholders (Type II agency costs).
- Aligning firm behaviour with stakeholder and governmental objectives, lowering regulatory and relational frictions.
- Reallocating cash flows toward productive, observable uses, improving financial performance and governance credibility.

## **7. Implications for Research and Policy**

This case contributes to the corporate governance literature by providing empirical support for ESG reporting as a substantive governance mechanism rather than a purely symbolic form of disclosure. It identifies agency cost reduction as a key pathway through which ESG

practices generate value, particularly in emerging market contexts where formal institutional protections may be less developed. From a policy perspective, the results indicate that the promotion of standardized ESG reporting frameworks can serve as a useful complement to traditional corporate governance reforms. At the firm level, ESG reporting should be understood as an internal governance and control mechanism, as well as a strategic management tool, rather than being treated solely as a reputational signalling device (Xu et al., 2025).

### 8. Theoretical underpinning

Stakeholder theory emphasizes that firms should consider and balance the interests of a broad range of stakeholders, rather than focusing exclusively on shareholder returns. It highlights the importance of diverse and effective boards in representing varied perspectives, particularly with respect to environmental and sustainability-related concerns (Al-Jaifi et al., 2023). From this perspective, firm performance and long-term success depend not only on shareholder priorities, but also on the interests of employees, customers, local communities, and the natural environment, reflecting legal, economic, and ethical responsibilities (Cheng et al., 2023). Accordingly, improvements in corporate governance practices play a central role in strengthening corporate social performance (DasGupta & Pathak, 2023). The development of durable stakeholder relationships requires firms to actively engage with stakeholder expectations and to provide transparent disclosure of sustainability-related activities through ESG reporting. Such transparency helps build trust and accountability, reinforcing the integration of stakeholder concerns into corporate decision-making processes (Bamahros et al., 2022; Alotaibi & Al-Dubai, 2024b).

TABLE I. THEORETICAL UNDERPINNING

(RQ)	Empirical Case Context	Key Governance Outcomes	Agency Theory Perspective	Stakeholder Theory Perspective
RQ1:	EU (mandatory ESG) vs. Saudi Arabia (voluntary ESG)	Increased gender diversity, Increased board independence, ESG committees; sustainability expertise	Reduces monitoring costs via independent and diverse boards; strengthens oversight	Enhances board responsiveness to employees, society, regulators and investors

R Q 2:	Chi na A- shar e firm s; Dev elop ed mar kets & AW M sect or	ESG- linked pay: stronger pay and perform ance sensitivi ty; sectoral heteroge neity	Aligns managerial incentives with long term value; mitigates short- termism	Embeds social and environmen tal objectives into managerial accountabilit y
R Q 3:	Chi nes e liste d firm s ( Typ e I & Typ e II age ncy con flict s)	Lower manager ial opportu nism; lower e xpropria tion risk; increase d transpar ency and trust	Constrains free cash flow misus e; lowers agent and principal conflicts	Institutionali zes stakeholder orientation; improves legitimacy and rational contracting

#### IV. RESULTS AND DISCUSSIONS

Current research states that ESG reporting is no longer just a result of company policy, but a tool that changes how companies are managed. While traditional studies link these disclosures to better transparency, legitimacy, and risk management, this research shows that ESG reporting specifically reshapes board dynamics and executive pay, with around 40% of incentives tied to sustainability goals. Research about agency theory states that better disclosure limits poor management decisions, while stakeholder theories state that it builds trust and long-term value. However, instead of viewing ESG as a simple outcome, this study treats it as a governance mechanism that actively increases board diversity by 20-30% and reduces internal costs. By introducing an Integrated ESG-Governance Framework, this work moves beyond existing literature to show how reporting creates a continuous accountability loop that improves risk oversight and access to sustainable finance. (ESG reporting backed by formal standards strengthens corporate governance by improving board oversight, including

greater diversity and expertise, and linking executive incentives to measurable ESG outcomes. This enhanced reporting transparency helps reduce agency problems and shifts corporate focus toward broader stakeholder interests rather than only shareholder value. (Jing et al., 2025c). Stronger ESG performance leads to higher executive compensation levels, mainly because ESG improvements boost financial performance, which in turn raises pay. This effect is stronger in firms with high pollution and where the general manager isn't also the board chair, suggesting that corporate structure influences how ESG links to pay. (Yang et al., 2025b).

This study argues that ESG reporting is more than just a communication tool because it functions as an important part of a company's governance system and leads to real structural changes. When firms adopt global standards such as GRI or TCFD, they are more likely to appoint independent and diverse directors with expertise in sustainability and risk management. This strengthens board oversight and improves the quality of strategic decisions. ESG reporting also influences executive compensation. Instead of relying mainly on bonuses tied to short-term financial results, companies begin linking pay to measurable ESG targets. This reduces short-termism and better aligns management incentives with long-term corporate goals. In addition, greater transparency lowers agency costs by making it easier for shareholders and other stakeholders to monitor management performance. This shifts the company's focus from an only shareholder-oriented model to a broader stakeholder approach. ESG reporting acts as an embedded control system that fosters genuine accountability. To reinforce its effectiveness, policymakers should work on standardizing ESG frameworks and integrating ESG data into formal financial reporting systems so it can be audited and affect decision-making meaningfully.

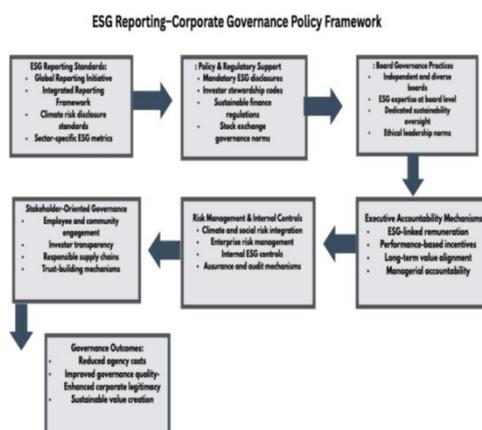


Figure 5 : ESG framework and integrating into formal financial reporting systems

## V. THEORETICAL ANCHOR:

Corporate governance is strengthened when ESG reporting causes managerial decision-making with stakeholder interests and long-term sustainability objectives to align. This research investigates how Environmental, Social, and Governance (ESG) reporting impacts internal corporate leadership and decision-making processes. Linking executive pay to specific sustainability goals helps businesses secure ethical investment and helps to build trust with stakeholders. To succeed, companies need to prioritize high-quality data systems to accurately track their social and environmental footprints. However, the study acknowledges that its findings might vary by region due to differing international regulations. Furthermore, the text clarifies that while governance improvements are evident, the long-term financial benefits of

these practices require more empirical evidence. The source ultimately serves as a guide for modernizing strategic reporting to meet transparency standards.

#### VI. FUTURE DIRECTIONS:

By using firm-level panel data and cross-country comparative studies, researchers can accurately determine how diverse institutional contexts, and regulatory environments mediate the impact of these disclosures. Furthermore, there is a need to quantify the long-term financial performance effects of ESG reporting, particularly regarding how strong data governance and the alignment of executive remuneration with sustainability indicators influence investor credibility.

#### VII. CONCLUSION:

This research shows that ESG reporting has evolved from a basic compliance task into a vital tool for corporate strategy, helping firms to balance the needs of all stakeholders rather than just shareholders. By adopting international standards, companies can improve board diversity and reduce internal costs, leading to better long-term performance. To put this into practice, leaders should link executive pay to ESG targets to gain investor trust and invest in stronger data systems to ensure reporting is accurate. However, because this study uses qualitative and secondary data, these findings may vary in different countries and do not yet provide a specific measurement of long-term financial impact.

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