

ESG AND ORGANIZATIONAL VALUE

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Abstract

The article examines how ESG factors are linked to a company's value. While many studies have explored how ESG performance and ESG disclosure remains understudied. The findings show that stakeholders consider both a company's ESG achievements and the transparency of its reporting when evaluating its value. Strong ESG performance increases market value, whereas ESG weaknesses reduce it. ESG disclosure on its own may lower firm value. Moreover, extensive ESG reporting weakens the positive effect of strong ESG performance but softens the negative impact of ESG shortcomings. For firms with strong ESG results, putting too much emphasis on ESG issues can harm their value, as investors may interpret excessive ESG focus as inefficient use of resources.

Keywords: ESG, SG, correlation, the value of the organization.

Introduction

In the work we are examine the interaction between a firm's actual ESG performance, the quality and extent of its ESG disclosure, and how these factors jointly affect firm value. Although the academic literature has extensively analyzed the motivations behind ESG reporting and its impact on corporate behavior and financial performance, the combined effect of ESG performance and ESG disclosure on market valuation remains insufficiently explored. The study's initial hypothesis is that the transparency of ESG disclosure influences Two opposing perspectives exist regarding the impact of ESG disclosure. The first suggests that greater transparency reduces information asymmetry between a firm and its stakeholders. In this case, investors gain a more accurate understanding of the firm's ESG-related strengths and weaknesses, which may enhance investor confidence and, consequently, increase the firm's market value. how ESG performance is reflected in firm value: information disclosure may either amplify or attenuate the effect of ESG activities. The second perspective argues that firms may use ESG disclosure strategically to create an appearance of strong social and environmental responsibility without implementing substantive changes in their core operations. Such practices, commonly referred to as greenwashing, may mislead investors. If stakeholders perceive ESG reporting primarily as

a reputational tool rather than a reflection of genuine ESG performance, this can undermine trust and negatively affect firm value.

Voluntary ESG initiatives require firms to allocate additional financial, human, and organizational resources. This leads to higher operating costs and, in the short term, may reduce profitability. Nevertheless, the increasing adoption of ESG practices across firms suggests that long-term benefits are expected to outweigh short-term costs.

Companies that consistently work to mitigate environmental, social, and governance risks are perceived as more resilient and forward-looking. This perception can enhance market valuation, as investors associate such firms with a lower likelihood of future losses, regulatory penalties, reputational damage, or disruptions in supply chains.

Furthermore, ESG-related activities can improve relationships with key stakeholders, including suppliers, customers, employees, and regulatory authorities. Stronger stakeholder trust may translate into more favorable contractual terms, lower transaction costs, and greater operational efficiency.

To date, the academic literature has not reached a consensus on this issue. Early studies widely argued that environmental and social investments exceeding minimum legal requirements impose additional costs, reduce profitability, and ultimately decrease firm value. This view is commonly associated with shareholder theory, rooted in classical economic thought. Proponents of this theory emphasize that compliance with legally mandated minimum environmental standards does not imply that investments in corporate social responsibility are financially recoverable.

In contrast to this view, more recent studies identify a wide range of benefits and additional value creation for firms that integrate ESG approaches into their operations, forming the foundation of stakeholder theory (also referred to as resource-based theory). According to this perspective, ESG activities can enhance firm value by strengthening managerial capabilities, improving corporate reputation among business partners, customers, and potential employees, and reducing reputational risks and, consequently, the cost of capital. Collectively, these factors may positively affect firm performance and provide a sustainable competitive advantage.

It is therefore concluded that the maximization of long-term firm value and a stable market position are achievable only when the interests of all stakeholders connected to the firm are adequately addressed. Nevertheless, a unified view on the overall significance of ESG factors has not yet emerged. While some studies report a negative relationship or no significant effect, meta-analytical evidence suggests that the overall impact remains positive, although it tends to weaken over time.

In the early 1990s, fewer than 20 companies disclosed publicly available ESG information; by 2016, however, the number of firms publishing sustainability reports or integrated reports had increased to approximately 9,000.

From a theoretical perspective, the relationship between ESG performance and firm valuation is not straightforward. Multiple mechanisms through which ESG activities

influence firm value may operate both directly and indirectly. In particular, ESG initiatives that exceed legally mandated standards entail additional, non-essential costs. As a result, early interpretations of this relationship were predominantly negative.

Empirical evidence from the majority of studies indicates a positive association between ESG performance and financial outcomes. One such study documents a positive relationship using a sample of nearly 17,000 firm-year observations over the period 1995–2007. Other studies similarly confirm a positive link. In a structural equation modeling framework, where economic performance is modeled as a function of environmental performance and control variables, researchers find a positive effect of environmental indicators on economic outcomes. These findings further suggest that ESG performance is positively associated with firm value, particularly in regions with weaker institutional environments, as ESG practices help mitigate the adverse effects of institutional failures. ESG disclosure represents a non-standardized and voluntary form of reporting that varies substantially in format and level of detail. Currently, many firms adhere to unified reporting frameworks, such as the Global Reporting Initiative (GRI). More recently, the International Integrated Reporting Initiative (IIR) introduced a new set of international ESG-related standards, first published in 2013. In addition to sustainability and integrated reports, firms increasingly rely on alternative channels to disclose ESG-related information.

Most early studies on ESG disclosure relied on manually constructed ratings and indices compiled by individual researchers, who collected data from annual reports and other publicly available sources. Limited access to ESG data and the lack of systematic disclosure significantly constrained empirical research in this field. In recent years, however, specialized commercial data providers have begun to aggregate ESG information, creating new opportunities for large-scale and more rigorous analysis.

Prior to examining the relationship between ESG disclosure and financial performance or firm valuation, it is essential to consider the heterogeneity of firms' motivations for disclosing ESG-related information. According to voluntary disclosure theory, firms with strong ESG performance are more inclined to provide extensive and detailed disclosure, whereas firms with weaker ESG outcomes tend to disclose only minimal information. Within this framework, companies use ESG disclosure as a signaling mechanism to differentiate themselves from less responsible firms and to mitigate the effects of adverse selection. Positive ESG performance contributes to a favorable public image, and firms with high ESG scores tend to exhibit higher valuation (or a lower cost of capital) only when such performance receives sufficient media coverage.

Nevertheless, firms may increase or reduce ESG disclosure for reasons beyond signaling superior performance. Companies may disclose additional ESG information to manage public perception and explain changes in ESG policies. For example, firms may enhance transparency to prevent or mitigate the negative consequences of major environmental incidents or other socially significant events that affect reputation and market valuation,

or to restore organizational legitimacy. Moreover, firms may use ESG reporting to project an image of greater social responsibility irrespective of actual practices—a phenomenon commonly referred to as greenwashing.

The preceding analysis demonstrates that the effect of ESG factors on firm value remains ambiguous, although the overall trend points to the growing strategic importance of sustainability practices. While early studies viewed environmental and social initiatives primarily as sources of additional costs, contemporary theories emphasize their potential to strengthen competitive advantages. Improvements in corporate reputation, risk reduction, enhanced stakeholder trust, and the optimization of internal processes collectively form the basis for long-term value creation. At the same time, the inconsistency of empirical findings highlights the complexity of ESG–value relationships and underscores the need for further research into the mechanisms through which sustainable behavior is translated into economic benefits.

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