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When does ESG create value? Corporate governance as a moderating mechanism in Indian firms

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Abstract

This study examines whether corporate governance determines if environmental, social and governance (ESG) performance translates into financial value for Indian listed firms. It draws on 711 firm year observations for 341 firms listed on the National Stock Exchange of India between 2019 and 2023. ESG data come from Refinitiv and accounting data from CMIE Prowess. The analysis uses firm and year fixed effects regressions with standard errors clustered at the firm level. Financial performance is measured by return on assets (ROA), with Tobin's Q used as a market-based robustness check. Governance quality is captured by a composite index covering board size, board independence, board gender diversity, CEO duality, audit committee independence, and foreign institutional ownership. ESG performance has no statistically significant direct association with either performance measure. However, the ESG–governance interaction is positive and significant for ROA, but insignificant for Tobin's Q. At the pillar level, the social interaction is positive and significant for ROA, while the governance interaction is marginally significant and the environmental interaction is insignificant. Although the estimated ESG effect on ROA varies across governance levels, the conditional effects are individually insignificant. The findings highlight the importance of considering ESG performance and corporate governance jointly when evaluating firm performance, while cautioning against assuming automatic financial returns.

***Keywords*:** ESG Performance, Corporate Financial Performance, Corporate Governance, Moderating Effect, Panel Data, India, Emerging Markets, BRSR, Fixed Effects Regression

JEL Classification: G30, G34, L25

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1. Introduction

The link between Environmental, Social, and Governance (ESG) performance and corporate financial performance (CFP) has become increasingly popular amongst researchers and practitioners over time. The rising awareness of problems connected to environmental issues like climate change and natural resource depletion, social issues like the influence on society and labor practices, and governance issues like unethical behavior and lack of diversity has heightened the demands of investors, customers, and other stakeholders towards companies (Heubeck T., 2024). Since the landmark meta-analysis conducted by Friede et al. (2015), summarizing 2,000 studies on the topic, the prevailing opinion has been that ESG integration is broadly compatible with and often supportive of financial value creation. However, behind the surface of this positive correlation hides much heterogeneity since there have been a fair number of studies showing no positive association or even an inverse correlation between ESG and CFP, while the causal mechanism linking them remains unclear (Orlitzky et al., 2003; Brammer et al., 2006). One important aspect of the problem that deserves greater consideration in this context is corporate governance. Corporate governance is a system of corporate management and control, including issues related to board structure, executive incentives, audit committees, ownership structure, and disclosure practices (Jensen & Meckling, 1976; Blair, 1995; OECD, 2015). From a complementarity perspective, good corporate governance should enhance the benefits of ESG by making the latter more credible, effectively implemented, and strategically focused on financial gain (Eccles et al., 2014; Fatemi et al., 2018). Weak governance, by contrast, may permit 'greenwashing', the adoption of ESG rhetoric without meaningful operational change, thereby severing the link between ESG scores and financial outcomes (Delmas & Burbano, 2011).

Given the above background, the Indian setting provides an especially interesting setting where the above hypothesis can be tested. India is one of the largest economies of the world with one of the most vibrant capital markets in Asia, despite its institutional diversity, concentration of ownership in families, and lower historical levels of governance quality (Sarkar et al., 2012; Khanna & Zyla, 2022). The two important regulatory changes that took place during the period under study include the implementation of the Companies Act (2013), requiring CSR spending from 2014 onwards, and SEBI mandating Business Responsibility and Sustainability Reporting (BRSR) for the top 1,000 listed companies from 2022–23 fiscal year (SEBI, 2021). In July 2023, SEBI added the BRSR Core, a subset of assessable indicators, phased in by market capitalisation from FY2023–24 (SEBI, 2023). Over the same window, the Kotak Committee reforms tightened board-level governance requirements for large listed firms (SEBI, 2017, 2018). The period 2019–2023 therefore captures a transition from largely voluntary, firm-specific ESG disclosure to a standardised, regulator-driven regime, alongside a parallel strengthening of board governance.

Nonetheless, despite all these characteristics, there are very few studies on the role of corporate governance as a moderator in the ESG – CFP relationship in Indian firms. This paper addresses

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this gap by asking: does corporate governance quality moderate the relationship between ESG performance and financial performance among Indian listed firms, and if so, how?

Prior work has mostly treated governance either as a control variable or as the "G" pillar of the ESG score. A small but growing literature models it as a moderator. What remains underexplored is whether a broad, multidimensional measure of board and ownership quality conditions the ESG–FP relationship, and whether it does so differently across the environmental, social, and governance pillars and between accounting and market outcomes, among India's largest listed firms.

This study addresses that gap. We examine (i) whether the Refinitiv ESG disclosure score is associated with accounting-based (ROA) and market-based (Tobin's Q) performance, and (ii) whether corporate governance quality, measured by a composite six-component index (CGI) built from Bloomberg governance data, moderates that relationship. CGI aggregates board size, board independence, board gender diversity, CEO–chair separation, audit committee independence, and foreign ownership. We estimate firm fixed-effects models with ESG × CGI interactions for the overall score and for each pillar.

This study makes three contributions to the ESG literature. First, it compares the ESG–ROA and ESG–Tobin's Q relationships side by side, and does so for the overall score and for each pillar, treating governance as a moderator of the ESG–FP relationship rather than as a control or an ESG pillar, which shifts the question from whether ESG pays to when and for which outcomes it does. Second, it operationalises governance through a composite six-variable index, which captures the combined effect of board structure, oversight and ownership mechanisms, in contrast to studies that isolate a single attribute (Bhagat & Bolton, 2008; Brown & Caylor, 2006; Gompers et al., 2003). Third, it uses firm fixed effects, which remove time-invariant unobserved heterogeneity such as promoter or group characteristics and sectoral culture, and so identify the relationship from within-firm variation, whereas much of the Indian evidence rests on cross-sectional designs (Maji, 2023) or dynamic GMM estimators (Dwibedi et al., 2024).

The remainder of the paper is structured as follows. Section 2 reviews the relevant literature and develops hypotheses. Section 3 describes the data, variables, and empirical methodology. Section 4 presents and interprets the results. Section 5 discusses them, Section 6 sets out implications, Section 7 notes limitations and future research, and Section 8 concludes.

2. Literature Review and Hypothesis Development

2.1 Institutional context: governance and disclosure reform in India

India's listed-firm governance regime rests on the Companies Act 2013 and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. The Act mandates CSR spending for qualifying companies, requires at least one-third of a listed company's board to be independent directors, requires at least one-woman director for prescribed classes of companies, and requires

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audit committees with an independent-director majority (Government of India, 2013; SEBI, 2015). Business groups and concentrated promoter ownership remain prominent features of the Indian corporate landscape (Khanna & Palepu, 2000), which makes the classic agency conflict one between controlling shareholders and minority investors as much as between managers and owners.

Following the Kotak Committee report (SEBI, 2017), SEBI amended the Listing Regulations in May 2018 (SEBI, 2018). The amendments required a minimum of six directors in the top 1,000 listed entities from April 2019, at least one independent woman director in the top 500 entities from April 2019 and in the top 1,000 from April 2020, and, from April 2020, a non-executive chairperson unrelated to the managing director or CEO in the top 500 entities. The chair–CEO separation requirement was later deferred and, in February 2022, made voluntary due to low compliance (SEBI, 2022). On the disclosure side, the BRSR became the mandatory sustainability reporting format for the top 1,000 listed entities from FY2022–23, with the BRSR Core and its assurance requirements phased in thereafter (SEBI, 2021, 2023).

2.2 Theoretical Framework

Three theoretical frameworks jointly motivate the ESG–governance–performance nexus. According to stakeholder theory (Freeman, 1984), organizations that engage in proactive management of relationships with stakeholders like employees, customers, suppliers, communities, and regulators avoid friction, reputation risk, and regulation; hence, their long-term profitability is improved. Agency theory (Jensen & Meckling, 1976) describes corporate governance as the system of governance mechanisms that align manager and shareholder interests to limit opportunism and improve decision-making. The point is that these two theories are complementary: governance mechanisms determine whether managerial attention and resources directed toward ESG activities generate authentic value or remain symbolic (Eccles et al., 2014). The resource-based view (Barney, 1991) supplies the third lens. ESG-intensive practices, such as embedded routines for environmental management, human capital development, and stakeholder engagement, can constitute valuable, rare, and difficult-to-imitate organisational capabilities that confer sustained competitive advantage. However, the resource-based view also implies that realising these advantages requires governance infrastructure to coordinate, monitor, and protect ESG-related investments from managerial opportunism or short-termism (Gillan et al., 2021); a valuable capability left ungoverned is not guaranteed to translate into superior performance. Critically, these frameworks are not independent: governance is the infrastructure that determines whether ESG-related resources and routines generate authentic strategic value or remain symbolic gestures. This complementarity perspective (Eccles et al., 2014; Gillan et al., 2021) implies that ESG and governance are super-additive inputs into firm value—each reinforces the other, and the interaction effect exceeds the sum of individual effects.

2.3 ESG Performance and Corporate Financial Performance

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Meta-analytic evidence points to a predominantly non-negative association between ESG and financial performance (Saxena & Begde, 2026; Friede et al., 2015). The findings are also consistent with Orlitzky et al. (2003) in terms of the meta-analysis conducted earlier for 52 articles. Event study evidence proves that ESG controversies affect firm value negatively (Krüger, 2015), and portfolio analysis reveals positive risk-adjusted excess returns for high-ESG stocks in different markets (Khan et al., 2016). On the other hand, in emerging markets, evidence is more inconsistent because of low institutional quality, leading to a lower informational value of ESG disclosure (Dhaliwal et al., 2011; Kaur & Lodhia, 2019). Brammer et al. (2006) and Nollet et al. (2016) report a negative or insignificant ESG-CFP relationship because direct costs related to ESG investments cannot be recouped through intangible benefits. With respect to India specifically, Bhatia and Tuli (2017) and Mondal and Sahu (2024) confirm a weak and unstable ESG-CFP relationship. Based on the foregoing, we state our first hypothesis in the null directional form to remain consistent with the emerging-market evidence:

H1: ESG performance has a statistically significant positive effect on firm financial performance in India.

H1a: Environmental performance is positively associated with ROA.

H1b: Social performance is positively associated with ROA.

H1c: Governance pillar performance is positively associated with ROA.

2.4 Corporate Governance and Financial Performance

Governance mechanisms operate as bundles and are likely to be substitutes or complements, so isolating a single mechanism risks mis-specification. The index approach has a long pedigree: the G-index (Gompers et al., 2003), the Gov-Score (Brown & Caylor, 2006) and the Indian governance index of Black and Khanna (2007) and Balasubramanian et al. (2010) all aggregate multiple provisions to capture overall governance quality and relate it to firm value. Bhagat and Bolton (2008) caution that governance measures are endogenous and that composites do not remove this problem, which motivates our firm fixed-effects design and the careful interpretation of results as associations. A composite measure also reduces noise from any single indicator and allows the moderating role of overall governance quality to be tested parsimoniously. We therefore construct CGI from six components, discussed individually in the literature review section.

On this basis, we expect the performance consequences of ESG to be more favourable in firms with stronger governance, which credibly commits management to implement what is reported and to deploy ESG resources productively. Because the index combines components that may have different or even opposing implications, positive moderation is a theory-based expectation to be tested, not a predetermined result.

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H2: Corporate governance quality, measured by CGI, positively moderates the relationship between overall ESG performance and firm performance, such that the relationship is stronger at higher levels of corporate governance quality.

CGI combines three board-structure indicators (size, independence, gender diversity), one leadership indicator (CEO–chair separation), one oversight indicator (audit committee independence) and one ownership indicator (foreign ownership). The rationale for each, and its expected contribution to the moderating role of governance, are set out below. These are expectations that justify the composition of the index; the formal hypotheses are tested at the composite level.

2.4.1 Board Size

One of the basic structural attributes of corporate governance that has been extensively studied is board size. Board size has well-understood but complex influences on financial and ESG results. From the resource dependence theory, the use of large boards means more expertise and network resources to deal with conflicting interests of stakeholders and foster ESG initiatives (Ntim & Soobaroyen, 2013). Larger boards are more capable of improving their CSR disclosure quality in terms of allocating tasks more effectively and having more experience, according to the findings of Jizi et al. (2014) in the field of CSR and sustainability disclosure. In banking, Belkhir (2009) also finds a positive connection between board size and the value of firm. Cheng (2008) provides evidence that despite potential coordination problems in the case of large boards, such boards have more stable yearly ROA and Tobin's Q and lower stock return volatilities, indicating the significant contribution of board size to performance stability. However, Jensen (1993) claims that although smaller boards can be more cohesive, they are not able to have enough knowledge to run diversified firms. In the NSE-500, spanning highly diverse sectors and firm sizes, board size heterogeneity is pronounced; its inclusion in the CGI captures the structural capacity of the board to govern complex, multi-stakeholder ESG programmes effectively. Consistent with the resource diversity hypothesis, larger board sizes are expected to influence ESG practices positively and, through this channel, impact the financial performance of the firm.

2.4.2 Board Independence

Board independence is the percentage of independent non-executive directors. Board independence is perhaps the most theoretically and empirically important corporate governance characteristic in the tradition of agency theory. According to Fama and Jensen (1983), outside directors who have no ties to managerial employment can offer effective monitoring of executive decisions, thereby lowering agency costs and protecting the interests of shareholders. Weisbach (1988) proves that independent boards take stricter actions against underperforming CEOs, while Klein (2002) demonstrates that independence decreases earnings management, thus increasing the credibility of disclosures. Within the context of ESG, board independence is especially significant because independent directors are capable of examining the strategic alignment of ESG

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investments, preventing appropriation of sustainability budgets by managers for their reputational gains, and requiring commitment rather than mere disclosures (Jo & Harjoto, 2011). As Ntim and Soobaroyen (2013) and Jain and Jamali (2016) demonstrate, higher levels of board independence enhance the connection between CSR and financial performance, which is also the case with the ESG-CFP link under consideration in this study. In India, SEBI's LODR regulations require at least one-third board independence or one-half where the chairperson is executive, providing a regulatory floor above which variation across NSE-500 firms enables identification of incremental independence effects. We expect higher independence to strengthen the ESG–FP link.

2.4.3 Board Gender Diversity

Board gender diversity has attracted rapidly growing empirical attention, with evidence converging on two complementary rationales for its positive effects on governance and performance. From a human capital perspective, women on boards contribute a variety of viewpoints, skills, and decision-making approaches that improve governance and result in more effective oversight (Adams & Ferreira, 2009). Adams and Ferreira (2009) further document that female directors exhibit stronger attendance records and a greater propensity to serve on monitoring-intensive committees, reinforcing overall board effectiveness. From a stakeholder perspective, gender diverse boards will be more focused on sustainability and corporate social responsibility, which will positively impact the firm's financial performance and reputation (Bear et al., 2010). Also, organizations with gender diverse boards show better accountability and transparency, thus minimizing agency conflicts (Srinidhi et al., 2011). Empirical evidence shows that gender diversity is positively related to Tobin's Q ratio (Campbell & Miniguez-Vera, 2008), and a meta-analysis conducted by Post and Byron (2015) found that diversity-performance relationships are most pronounced in the industries that require stakeholder engagement and innovation, the exact areas in which ESG activities create financial value. It was also shown empirically that gender diversity leads to increased ROE and ROA, especially where stakeholder-sensitive ESG activities are part of strategy (Campbell & Miniguez-Vera, 2008). In India, the Companies Act (2013) required at least one woman director in all listed firms, greatly increasing their presence in the NSE-500 during the period of the study. CGI measure of gender diversity includes both board and executive levels of diversity, as women must be involved in ESG activities not only as board members but as leaders executing such programs. We expect higher female representation to strengthen the ESG–FP link, consistent with the moderating role of gender diversity found by Alodat and Hao (2025).

2.4.4 CEO Duality

Duality of CEO is a corporate governance issue where the same person is appointed as the CEO and the chairman of the board. This issue has been subject to debate since the theory of corporate governance gives contradictory predictions in terms of performance of the firm based on the practice of dual CEOs. Those who support CEO duality claim that it enhances leadership efficiency

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in the firm, as it ensures a streamlined decision-making process without any friction between the board and management (Boyd, 1995). From the perspective of stewardship (Davis et al., 1997), the CEO-Chair acts as a steward for the organization's resources and can lead the firm efficiently. Rechner & Dalton (1991) found long-term evidence supporting the superior performance of firms with role separation compared to duality. Studies have also indicated the influence of size on the performance effect of CEO duality: Daily & Dalton (1997) and Mubeen et al. (2021) show that CEO duality can be advantageous for small firms, but can have adverse effects on larger firms due to their need for better governance by virtue of role separation. Regarding the ESG framework, CEO duality is particularly significant: the CEO-Chair can divert spending on sustainability to serve reputation purposes rather than creating value, without having an independent board overseeing them (Harjoto & Jo, 2015). Due to the mixed results concerning CEO duality, there needs to be an extensive examination of the effect that CEO duality can have as a moderator between ESG and financial performance, offering insight into situations where duality can lead to desirable results. In India, the separation requirement for the top 500 entities was scheduled for April 2020 but was deferred and then made voluntary in 2022 because compliance was low (SEBI, 2018, 2022); where firms separate the roles by choice, this plausibly signals commitment to board independence. We expect separation to strengthen the ESG–FP link, in line with Moussa et al. (2024).

2.4.5 Audit Committee

The audit committee holds a crucial place within the corporate governance structure in that it is the tool that facilitates the board's oversight of financial reporting, internal controls, risk management, and recently even non-financial reporting, such as ESG. DeZoort et al. (2002) and Dwibedi & Pahi (2026) have shown that audit committee effectiveness depends on the independence of its members, their financial expertise, its authority (the existence of the formal audit committee charter), and diligence in meetings and deliberations. Klein (2002) shows that companies with independent audit committees are less likely to engage in earnings management, thus linking composition of the committee with the quality of disclosures. In the context of ESG governance, the function of the audit committee is especially significant in light of the materiality of the sustainability disclosures – independent, financially expert audit committees exercising consistency in non-financial assertions help prevent greenwashing (Chen & Xie, 2022; Zahid et al., 2022). According to the Indian Companies Act (2013), and LODR issued by SEBI, there must be at least two-thirds of the audit committee members who are independent directors with adequate financial knowledge, an aspect that significantly improves the governance of both financial and ESG reporting when substantially met. We expect higher audit committee independence to strengthen the ESG–FP link .

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2.4.6 Foreign Institutional Ownership

Foreign Institutional Investors (FIIs) and Foreign Portfolio Investors (FPIs) represent a unique form of governance system for Indian capital markets which works through exit threats as well as voice mechanisms (Hirschman, 1970; Aggarwal et al., 2011). FIIs are more governance-oriented and ESG-conscious than domestic investors, as they are bound by the fiduciary duty imposed by their domestic regulatory bodies, especially European and North American FIIs, which are governed by stewardship guidelines and UNPRI principles, and have better analytical and benchmarking skills (Ferreira & Matos, 2008). Aggarwal et al. (2011) show in an international panel study that foreign institutional holdings causally improve board independence, audit quality, and shareholder rights, thus making FIIs an exogenous upgrading mechanism of governance. About ESG, McGuinness et al. (2017) find that foreign ownership significantly enhances CSR performance of Chinese listed companies, and Bhat et al. (2023) prove that the presence of FIIs is positively related to ESG initiatives of Indian companies. In addition to being a form of discipline, FII ownership offers exposure to global capital markets that incorporate ESG performance in valuation multiples, thus offering market-driven motivation to engage in sustainable investments that domestically owned companies might not necessarily experience (Eccles et al., 2014). In India, where promoter-owned businesses have always posed governance problems due to concentrated share ownership, FII ownership constitutes a salient form of governance heterogeneity. FII ownership in the CGI accounts for external monitoring pressure and international ESG performance standards with the assumption that increased foreign ownership raises ESG's financial payoffs through greater international scrutiny.

2.5 Corporate Governance as a Moderator of ESG–CFP

Jo and Harjoto (2011, 2012) and Ntim and Soobaroyen (2013) document that board independence and size strengthen the ESG–CFP relationship. Fatemi et al. (2018) demonstrate that ESG's value relevance is higher when it is combined with high-quality disclosure governance. The mechanisms are threefold: (i) independent audit and sustainability committees validate ESG disclosures, raising their credibility to capital markets (Chen & Xie, 2022); (ii) well-governed boards direct ESG investment toward long-run value rather than managerial reputation enhancement (Jo & Harjoto, 2011); and (iii) foreign institutional investors are sensitive to ESG quality signals and provide additional monitoring that reinforces strategic ESG orientation (Bhat et al., 2023). In India specifically, Kumar et al. (2024) identify governance as the primary boundary condition on ESG effectiveness, and Mitra et al. (2025) find the moderating effect most pronounced in family-controlled firms. A composite governance index may capture the broader capacity of firms to oversee these activities but may also conceal differences among its components. We therefore test whether CGI moderates each pillar's association with performance, expecting positive moderation where governance supports implementation, monitoring, and accountability. For the governance pillar, any interaction with CGI should be read with the construct overlap in mind.

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H2a: Corporate governance quality positively moderates the relationship between environmental performance and firm performance.

H2b: Corporate governance quality positively moderates the relationship between social performance and firm performance.

H2c: Corporate governance quality positively moderates the relationship between governance pillar performance and firm performance.

3. Methodology

3.1 Data and Sample

The study covers NSE 500 firms over 2019–2023 and begins with an initial panel of 2,045 firm-year observations. ESG scores (overall and pillar scores) and the firm financial variables are obtained from Refinitiv, and the governance variables used to construct CGI are obtained from Bloomberg. The dependent variables are ROA (accounting-based performance) and Tobin's Q (market-based performance). The main explanatory variables are the ESG score, with its environmental (EPS), social (SPS), and governance (GPS) pillar scores, and CGI. The control variables are firm size (lnta, the natural logarithm of total assets), leverage (lev), and the weighted average cost of capital (waccp).

The estimation samples are complete-case samples. Table 1 presents the sample availability and the number of firm-year observations included in each estimation model, highlighting differences in sample size due to data availability across variables. This accounts for most of the reduction from the initial panel. After also requiring non-missing outcome and control variables, the ROA models use 709 firm-year observations from 340 firms (overall ESG) and 708 observations from 339 firms (pillar models), and the Tobin's Q models use 711 observations from 341 firms and 710 observations from 340 firms, respectively. The small differences in counts reflect differences in the availability of ROA, Tobin's Q, and the pillar scores. Because the sample is restricted to firms with both Refinitiv ESG and Bloomberg governance coverage, the results apply to such firms and may not generalise to other NSE 500 firms.

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Table 1. Sample availability and estimation samples

Variable / sample	Non-missing	Missing	Notes
Initial firm-year panel	2,045	—	2019–2023
ROA	2,035	10	Outcome
Tobin's Q	2,041	4	Outcome
ESG score	1,246	799	Main explanatory variable
CGI	1,070	975	Requires all six components
Firm size (lnta)	2,041	4	Control
Leverage (lev)	2,041	4	Control
WACC (waccp)	2,040	5	Control
ROA models, overall ESG	709	—	340 firms
ROA models, pillar scores	708	—	339 firms
Tobin's Q models, overall ESG	711	—	341 firms
Tobin's Q models, pillar scores	710	—	340 firms

Note. Counts for individual variables are full-panel counts and should not be added together. Estimation samples require non-missing outcome, ESG score, CGI, controls, and year. *Source:* Authors' calculations.

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3.2 Variables and the governance index (CGI)

ESG is the Refinitiv overall ESG disclosure score (0–100) and, in the pillar models, the environmental (EPS), social (SPS), and governance (GPS) pillar disclosure scores. Because these scores are built from company-reported data, they are interpreted as reflecting reported ESG activity and commitments.

Table 2 outlines the six components of the Corporate Governance Index (CGI), including their respective indicators and scoring criteria used to construct the composite governance measure. Corporate governance is measured by CGI, a composite of six components commonly examined in the governance literature. To make the components comparable, we min–max normalise board size to a 0–1 scale, convert percentage-based measures to proportions, and code CEO–chair separation as a binary indicator: 1 when the roles are separate and 0 when they are combined (reversing the original data) (Nasir et al., 2023). The six components receive equal weights, and CGI is their arithmetic mean for firm-years with complete data on all six components. Higher values indicate stronger governance on the combined measure. CGI is a study-specific index: its components, equal weights and normalisation are chosen on theoretical grounds and have not been validated against other governance measures, so the findings apply to this operationalisation.

Table 2. Components of CGI

Component	Operationalisation	Construction in the index
Board size	Number of directors	Min–max normalised to 0–1
Board independence	Percentage of independent directors	Divided by 100
Board gender diversity	Percentage of women directors	Divided by 100
CEO–chair separation	Whether the CEO and chairperson roles are separate	1 = separate roles; 0 = combined roles
Audit committee independence	Percentage of independent audit committee members	Divided by 100
Foreign ownership	Percentage of shares held by foreign investors	Divided by 100
CGI	Six components	Equal-weighted mean; all six required

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3.3 Model Specification

This study examines the relationship between environmental, social, and governance (ESG) performance and firm financial performance, while investigating the moderating role of corporate governance quality. Return on assets (ROA) is used as the primary measure of financial performance. The analysis is conducted using firm and year fixed-effects models to account for time-invariant firm-specific characteristics and year-specific effects, respectively.

To examine the association between overall ESG performance and ROA, the following baseline model is specified:

The baseline model is a firm fixed-effects panel regression with year effects:

Base Model –

$$ROA_{it} = \alpha_i + \lambda_t + \beta_1 ESG_{it} + \gamma_1 lnta_{it} + \gamma_2 lev_{it} + \gamma_3 waccp_{it} + \varepsilon_{it}$$

where ROA is a measure of financial performance, α_i are firm fixed effects, λ_t are year effects, and the controls are firm size (lnta), leverage (lev), and the weighted average cost of capital (waccp). Standard errors are clustered at the firm level. The same specification is estimated with each pillar score (EPS, SPS, GPS) in place of the overall ESG score.

To assess the individual associations of the environmental, social, and governance pillars with ROA, the overall ESG score is replaced with the respective pillar score in separate model specifications:

$$ROA_{it} = \alpha_i + \lambda_t + \beta_1 EPS_{it} + \gamma_1 lnta_{it} + \gamma_2 lev_{it} + \gamma_3 waccp_{it} + \varepsilon_{it}$$

$$ROA_{it} = \alpha_i + \lambda_t + \beta_1 GPS_{it} + \gamma_1 lnta_{it} + \gamma_2 lev_{it} + \gamma_3 waccp_{it} + \varepsilon_{it}$$

$$ROA_{it} = \alpha_i + \lambda_t + \beta_1 SPS_{it} + \gamma_1 lnta_{it} + \gamma_2 lev_{it} + \gamma_3 waccp_{it} + \varepsilon_{it}$$

Where EPS is the environmental pillar score, SPS is the social pillar score, and GPS is the governance pillar score. These models correspond to hypotheses H1 and H1a–H1c.

To investigate whether corporate governance quality moderates the relationship between ESG performance and financial performance, the following interaction model is estimated:

$$ROA_{it} = \alpha_i + \lambda_t + \beta_1 ESG_{it} + \beta_2 CGI_{it} + \beta_3 (ESG_{it} \times CGI_{it}) + \gamma_1 lnta_{it} + \gamma_2 lev_{it} + \gamma_3 waccp_{it} + \varepsilon_{it}$$

The moderating role of corporate governance is examined by replacing the overall ESG score with each pillar score in separate specifications:

$$ROA_{it} = \alpha_i + \lambda_t + \beta_1 EPS_{it} + \beta_2 CGI_{it} + \beta_3 (EPS_{it} \times CGI_{it}) + \gamma_1 lnta_{it} + \gamma_2 lev_{it} + \gamma_3 waccp_{it} + \varepsilon_{it}$$

$$ROA_{it} = \alpha_i + \lambda_t + \beta_1 GPS_{it} + \beta_2 CGI_{it} + \beta_3 (GPS_{it} \times CGI_{it}) + \gamma_1 lnta_{it} + \gamma_2 lev_{it} + \gamma_3 waccp_{it} + \varepsilon_{it}$$

$$ROA_{it} = \alpha_i + \lambda_t + \beta_1 SPS_{it} + \beta_2 CGI_{it} + \beta_3 (SPS_{it} \times CGI_{it}) + \gamma_1 lnta_{it} + \gamma_2 lev_{it} + \gamma_3 waccp_{it} + \varepsilon_{it}$$

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These interaction models correspond to hypotheses H2 and H2a–H2c. The coefficient β_3 captures the direction and statistical significance of the moderating association. A positive and statistically significant interaction coefficient would indicate that the association between the relevant ESG measure and ROA becomes more positive as corporate governance quality increases.

In all models, (i) denotes the firm and (t) denotes the year. The term α_i represents firm fixed effects, λ_t represents year fixed effects, and ε_{it} is the error term. The control variables are firm size (lnta), leverage (lev), and weighted average cost of capital (waccp).

4. Results

4.1 Descriptive Statistics and Sample Coverage

Table 3 reports descriptive statistics for the full panel; the number of observations differs across variables because of data availability, as explained in Section 3.1.

Table 3. Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	2,035	0.07	0.12	−1.46	1.11
Tobin's Q	2,041	3.63	4.55	0.49	75.86
ESG score	1,246	49.82	17.15	4.69	92.66
CGI	1,070	0.46	0.10	0.01	0.67
Firm size (lnta)	2,041	7.49	1.74	2.42	13.60
Leverage (lev)	2,041	0.58	0.75	0.00	16.74
WACC (waccp)	2,040	0.11	0.03	−0.07	0.26

Note. Statistics are for the full panel before the complete-case restriction described in Section 3.1. We applied no winsorisation or trimming; variables are used as reported, except for removing implausible foreign-ownership and board-size values described in Section 3.2. *Source:* Authors' calculations.

ROA has a mean of 0.07, and Tobin's Q has a mean of 3.63, with considerable dispersion in both. The ESG score has a mean of 49.82 and a standard deviation of 17.15, and CGI has a mean of 0.46 and a standard deviation of 0.10. Because extreme values were retained, Tobin's Q (maximum 75.86) and leverage (maximum 16.74) are right-skewed, which may add noise to the estimates, particularly for Tobin's Q. In the ROA estimation sample, the 25th percentile, median, and 75th percentile of CGI are 0.4207, 0.4795, and 0.5254.

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The reduction from 2,045 observations to the estimation samples is mainly due to missing ESG scores (799 firm-years) and the requirement that all six CGI components be available (975 missing firm-years). This improves the consistency of the composite but can create selection concerns if firms with complete data differ systematically from those without. The results should therefore be read as applying to firms with available Refinitiv ESG and Bloomberg governance coverage.

4.2 Correlation Analysis

Table 4 presents pairwise Pearson correlations with associated p-values. ROA is positively correlated with Tobin's Q (0.150), the ESG score (0.076), and CGI (0.069), and the ESG score is positively correlated with CGI (0.076) and Tobin's Q (0.060). Leverage has a strong negative correlation with ROA (−0.570), and firm size is negatively correlated with both ROA and Tobin's Q. No pair of control variables has an absolute correlation above 0.30. The correlations are descriptive and do not establish causality.

Table 4. Correlation Matrix

	ROA	Tobin's Q	ESG	CGI	lnta	lev	waccp
ROA	1.000						
Tobin's Q	0.150	1.000					
ESG	0.076	0.060	1.000				
CGI	0.069	0.096	0.076	1.000			
lnta	−0.176	−0.382	0.256	−0.052	1.000		
lev	−0.570	0.151	−0.020	−0.040	0.117	1.000	
waccp	0.071	0.039	−0.087	−0.024	−0.285	−0.139	1.000

Note. Pairwise correlation coefficients are reported without significance markers and are presented for descriptive purposes only.
Source: Authors' calculations.

4.3 Main fixed-effects estimates: ROA

Table 5 reports the ROA models. In all four models, leverage is negatively and significantly associated with ROA ($p < 0.001$), whereas firm size and WACC are insignificant ($p > 0.20$), so leverage is the most consistent control-variable correlate of accounting profitability. The results suggest that higher debt burdens may constrain profitability, consistent with evidence from Indian firms (Chadha & Sharma, 2015).

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The overall ESG score is negatively associated with ROA and statistically significant (β = −0.00201, p = 0.006) when CGI equals zero. However, this coefficient should not be interpreted as the average relationship between ESG and profitability because the model includes an interaction term. The positive and significant ESG × CGI coefficient (β = 0.00416, p = 0.027) indicates that the estimated association between ESG and ROA becomes more positive as corporate governance improves. This finding suggests that governance may condition the financial implications of ESG performance, consistent with H2a. Nevertheless, the interaction establishes a conditional association, not a causal effect, and the ESG–ROA relationship at specific governance levels should be examined before concluding where it becomes positive or statistically significant.

The environmental score is not significantly associated with ROA (β = 0.00006, p = 0.966), and its interaction with CGI is also statistically insignificant (β = −0.00122, p = 0.667). These results provide no evidence that environmental performance is associated with ROA or that corporate governance significantly changes this relationship in the estimated model. Accordingly, H3a is not supported. The findings should be interpreted as an absence of statistically significant evidence rather than proof that environmental initiatives have no financial value.

The social score has a negative and statistically significant coefficient when CGI equals zero (β = −0.00124, p = 0.032). In contrast, the positive and significant social score × CGI interaction (β = 0.00272, p = 0.015) indicates that the estimated association between social performance and ROA becomes more positive as corporate governance improves. This provides evidence that governance conditions the relationship between social performance and profitability, supporting H3b. However, the coefficient on the social score alone does not establish a negative relationship across all governance levels.

The governance pillar has a negative coefficient that is statistically significant at the 10% level (β = −0.00174, p = 0.079), while its interaction with CGI is positive and significant at the 10% level (β = 0.00391, p = 0.096). These results offer only weak evidence that the association between the governance pillar and ROA becomes more positive as the separate corporate governance index increases. Moreover, because the ESG governance pillar and CGI may capture overlapping governance characteristics, this result should be interpreted cautiously. The CGI coefficient (β = −0.13807, p = 0.058) is also significant only at the 10% level and represents the conditional association when the governance score equals zero, rather than an average governance effect.

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Table 5. Firm fixed-effects regressions: dependent variable ROA

Variable	(1) Overall ESG	(2) Environmental	(3) Social	(4) Governance
ESG score	−0.00201***			
	(0.00073)			
Environmental score (EPS)		0.00006		
		(0.00138)		
Social score (SPS)			−0.00124**	
			(0.00057)	
Governance score (GPS)				−0.00174*
				(0.00099)
CGI	−0.15402***	0.11217	−0.09607	−0.13807*
	(0.05841)	(0.16816)	(0.06700)	(0.07249)
ESG × CGI	0.00416**			
	(0.00187)			
EPS × CGI		−0.00122		
		(0.00284)		
SPS × CGI			0.00272**	
			(0.00112)	
GPS × CGI				0.00391*
				(0.00234)
Firm size (lnta)	0.00596	0.00849	0.00600	0.00364
	(0.03597)	(0.03637)	(0.03701)	(0.03489)
Leverage (lev)	−0.34568***	−0.34224***	−0.34736***	−0.34052***
	(0.05231)	(0.05925)	(0.05958)	(0.05924)
WACC (waccp)	0.12854	0.13734	0.12822	0.12169
	(0.10599)	(0.10878)	(0.10797)	(0.11602)
Year fixed effects	Yes	Yes	Yes	Yes
Firm fixed effects	Yes	Yes	Yes	Yes
Observations	709	708	708	708
Firms	340	339	339	339
Within R^2	0.3044	0.2976	0.2984	0.3119
Model F-statistic	4.98***	5.99***	4.98***	5.56***

Note. Firm-clustered standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$. Year indicators (2020–2023) and the constant are estimated but not reported; no year indicator is individually significant. *Source:* Authors' calculations.

4.4 ROBUSTNESS TEST - Tobin's Q

Table 6 reports the Tobin's Q models. The robustness analysis examines whether the findings remain consistent when overall ESG performance is disaggregated into its environmental, social, and governance pillars. The results indicate that the overall ESG coefficient is negative and statistically significant, while the environmental pillar exhibits a negative association with firm value at a weaker significance level.

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Table 6. Firm fixed-effects regressions: dependent variable Tobin's Q

Variable	(1) Overall ESG	(2) Environmental	(3) Social	(4) Governance
ESG score	−0.0398**			
	(0.0199)			
Environmental score (EPS)		−0.0267*		
		(0.0149)		
Social score (SPS)			−0.0211	
			(0.0166)	
Governance score (GPS)				−0.0260
				(0.0166)
CGI	−0.3294	−0.2218	−2.3497	0.2514
	(3.2451)	(1.8044)	(2.0670)	(2.3115)
ESG × CGI	0.0140			
	(0.0562)			
EPS × CGI		0.0145		
		(0.0334)		
SPS × CGI			0.0462	
			(0.0355)	
GPS × CGI				0.0035
				(0.0359)
Firm size (lnta)	−2.0552***	−2.1072***	−2.1719***	−2.0648***
	(0.5289)	(0.5705)	(0.5585)	(0.5316)
Leverage (lev)	−1.2575	−1.3142	−1.3994	−1.4027
	(0.9241)	(0.8580)	(0.8584)	(0.9388)
WACC (waccp)	−5.0860	−5.4199	−5.9875	−6.1556
	(5.6373)	(5.7529)	(5.7066)	(5.7856)
Year fixed effects	Yes	Yes	Yes	Yes
Firm fixed effects	Yes	Yes	Yes	Yes
Observations	711	710	710	710
Firms	341	340	340	340
Within R^2	0.0414	0.0400	0.0365	0.0440
Model F-statistic	5.33***	4.45***	4.40***	6.42***

Note. Firm-clustered standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$. Year indicators and the constant are estimated but not reported. *Source:* Authors' calculations.

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The coefficients for the social and governance pillars are statistically insignificant. Importantly, all interaction terms between CGI and the respective ESG measures are statistically insignificant, providing no evidence of a moderating effect of corporate governance in these alternative specifications. Firm size remains negative and statistically significant across all models, whereas leverage and WACC are insignificant. Overall, the robustness results offer limited support for a negative ESG–firm value association but do not establish the moderating role of corporate governance. The findings provide a nuanced understanding of the relationship between environmental, social, and governance (ESG) performance and corporate financial performance among Indian listed firms. The main ROA model indicates a positive and statistically significant interaction between overall ESG performance and corporate governance ($\beta = 0.000426$, $p = 0.009$). This suggests that the association between ESG performance and accounting profitability becomes more positive as the governance index increases. However, the direct coefficient on ESG performance is statistically insignificant ($p = 0.542$), indicating that the relationship between ESG and ROA is conditional on the level of corporate governance rather than uniformly positive across firms.

These findings are broadly consistent with stakeholder theory, which suggests that responsible business practices can strengthen relationships with stakeholders and potentially contribute to organisational performance (Freeman, 1984). Waddock and Graves (1997) also identify a relationship between corporate social performance and financial performance, while Friede et al. (2015), in their synthesis of more than 2,000 empirical studies, report that the ESG–financial performance relationship is predominantly non-negative. Nevertheless, the present findings indicate that such relationships may depend on organisational and governance-related conditions. The positive interaction is consistent with the possibility that stronger governance arrangements complement ESG-related activities, although the observational design does not establish a causal mechanism.

The conditional marginal-effects results provide additional insight into the ROA relationship. The association between overall ESG performance and ROA is statistically significant at higher governance-index values, while the interaction coefficient indicates that the estimated ESG slope changes with governance. However, these conditional estimates should be interpreted at the specific governance values examined and should not be generalised to all firms or governance levels.

The Tobin's Q robustness analysis provides a different perspective. The overall ESG coefficient is negative and statistically significant ($\beta = -0.0398$, $p = 0.046$), whereas the ESG × CGI interaction is statistically insignificant ($\beta = 0.0140$, $p = 0.803$). Thus, the robustness specification does not provide evidence that corporate governance significantly moderates the relationship between overall ESG performance and market-based firm value. The negative ESG coefficient

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represents a conditional association at CGI = 0 and should not be interpreted as evidence that ESG engagement generally reduces firm value.

This difference between ROA and Tobin's Q is relevant because accounting profitability and market valuation capture distinct aspects of corporate performance. ESG initiatives may involve implementation and monitoring costs, while their potential reputational or strategic benefits may materialise over different time horizons. Wang et al. (2016) highlight that the sustainability–financial performance relationship varies with research characteristics and performance measures. The present findings are consistent with the need to distinguish accounting-based outcomes from market-based outcomes rather than assume that ESG performance has a uniform relationship with both.

The pillar-level robustness results further demonstrate that the relationships between ESG dimensions and firm value are not identical. Environmental performance has a negative coefficient with relatively weak statistical evidence, while the social and governance pillar coefficients are statistically insignificant. None of the interactions between CGI and the individual ESG pillars is statistically significant in the Tobin's Q specifications. These results indicate that the moderation observed in the main ROA model is not consistently reproduced when performance is measured using Tobin's Q and ESG is disaggregated into its individual pillars.

Evidence from India also points to variation in ESG–performance relationships. Rao et al. (2023), examining Indian firms, report that the financial implications of ESG pillars can vary across performance conditions. Veeravel et al. (2024) identify a positive relationship between ESG disclosure and firm performance among Indian listed firms. Although differences in samples, measures and model specifications limit direct comparisons, these studies reinforce the importance of examining ESG dimensions and performance measures separately. The present findings add to this discussion by examining corporate governance as a moderator and showing that the evidence for moderation differs between ROA and Tobin's Q.

Overall, the results provide qualified evidence that corporate governance conditions the relationship between ESG performance and accounting profitability. However, this pattern is not confirmed in the market-based robustness models. The findings therefore support a conditional interpretation of the ESG–financial performance relationship rather than a universal expectation that higher ESG performance is associated with better outcomes across all financial indicators.

5. Implications

5.1 Theoretical Implications

The findings contribute to the ESG–financial performance literature by highlighting corporate governance as a potential contextual factor in the relationship between ESG performance and accounting profitability. The positive ESG × CGI interaction in the ROA model is consistent with stakeholder theory, as governance arrangements may help firms oversee and coordinate ESG-

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related activities. However, the insignificant interaction in the Tobin's Q model indicates that this relationship is not consistent across performance measures. The findings also highlight the importance of distinguishing aggregate ESG scores from individual environmental, social, and governance pillars.

5.2 Managerial Implications

For boards and senior managers, the findings suggest that ESG initiatives should be considered alongside governance arrangements, accountability structures and strategic decision-making. Rather than treating ESG scores as standalone indicators of business performance, firms may benefit from integrating sustainability priorities into established governance and monitoring processes. However, the results do not guarantee that stronger governance or higher ESG scores will automatically improve profitability or market valuation. For investors and financial analysts, the results highlight the importance of assessing ESG performance alongside corporate governance and multiple financial indicators. A high ESG score alone may not be sufficient to infer superior market valuation, particularly when the relationship varies across accounting-based and market-based outcomes. For regulators and market institutions in India, the findings underscore the relevance of credible ESG disclosure and effective governance practices. They also suggest that evaluations of ESG initiatives should recognise the distinction between disclosure quality, governance arrangements and realised financial outcomes. Any regulatory or investment implications should be drawn cautiously because the study identifies associations rather than causal effects.

6. Limitations and Future Research

This study has several limitations that provide directions for future research. The study is limited by its five-year period, data availability, and the construction of the composite governance index. Firm fixed-effects models also cannot fully address endogeneity or establish causality. Future research could use longer panels, alternative governance measures, and stronger identification strategies to validate the findings.

7. Conclusion

This study examines whether corporate governance moderates the relationship between ESG performance and firm performance among NSE-listed Indian firms during 2019–2023. The findings provide evidence that the relationship varies across performance measures. For ROA, the positive and significant interaction between overall ESG performance and CGI indicates that the ESG–profitability association becomes more positive as governance quality increases. Similar moderation is observed for the social pillar, while the evidence for the governance pillar is weaker; no significant moderation is found for the environmental pillar. However, the Tobin's Q models

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show no significant ESG–CGI interactions, suggesting that the moderating role of governance is not consistently reflected in market-based firm value.

Overall, the findings highlight that ESG performance should not be viewed independently of corporate governance or treated as a guarantee of improved financial outcomes. The study contributes to the Indian ESG literature by demonstrating that governance may shape the relationship between ESG performance and accounting profitability, although this pattern does not extend to market valuation. Investors, managers and regulators should therefore consider ESG performance, governance quality and different measures of firm performance jointly. These conclusions should be interpreted cautiously given the study's sample coverage, five-year period and observational research design, which does not establish causality.

Data Availability

The ESG scores and financial data were obtained from Refinitiv, and the governance data from Bloomberg. Both are proprietary databases, and the data can be obtained from the providers under their licence terms.

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