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# Sustainable Business Practices and Their Relationship with Financial Performance in Competitive Markets

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**ABSTRACT**

Sustainable business practices have emerged as a primary interest of companies in increasingly competitive markets since stakeholders are seeking greater accountability in the environmental, social and governance (ESG) practices of businesses. Although the sustainability initiatives are normally linked to ethical accountability and value creation on the long-term, the fact that sustainability initiatives directly affect financial performance remains a controversial topic of debate. This paper will analyse how sustainable business practices based on ESG and firm financial performance are related in a competitive market context. The research design used is quantitative research design using the secondary data gathered using annual reports and sustainability disclosures of selected companies based on competitive industries. To measure ESG performance, the sample includes firms that are observed within a specific timeframe, and the measurement of ESG performance is based on a composite index, which includes environmental, social, and governance indicators. Key accounting-based metrics, such as Return on Assets (ROA) and Return on Equity (ROE) are used to evaluate the financial performance. The research uses descriptive statistics, correlation as well as the multiple regression to determine the relationship between the variables with control of firm size, leverage as well as the effect of the industry. The results show a positive and statistically significant correlation between ESG practices and financial performance, indicating that companies with sustainable practices in their operations are more likely to enjoy high profitability. The research paper adds to the already existing body of literature by offering empirical data of competitive markets, as well as the strategic significance of incorporating sustainability in the main business operations in order to be financially successful over time.

## 1. INTRODUCTION

Sustainable business practices have become a strategic priority issue of vital strategic concern of organizations operating in the market which have become increasingly competitive. It has become a requirement that firms consider the environmental, social, and governance (ESG) aspects in its core operations to achieve stakeholder expectations, address the regulatory imperatives, and create long-term value. It is no longer considered only as an ethical concern but as a strategic instrument that can lead to a more efficient operation, innovation, and corporate image. According to the existing literature, adoption of ESG practices are associated with improved firm performance, improved risk management and improved competitiveness in dynamic market environment [1], [2], [4], [12].

Sustainability in competitive markets is critical in helping firms to differentiate and remain resilient in the long term. Institutions that successfully put into practice ESG plans are likely to experience cost-efficiency, improved stakeholder relations, and socially responsible investments. Empirical evidence suggests that sustainability practices are becoming more closely linked with financial performance indicators like Return on Assets (ROA) and Return on Equity (ROE), albeit with varying strength and direction.

Although the concept of sustainability is gradually gaining an increasing significance, there exists a notable knowledge gap as to the stability of its influence on the financial performance, especially in the context of competitive and emerging marketplaces. Although some studies say that there is a positive relationship between ESG

practices and firm profitability, other studies reveal mixed or inconclusive results, indicating that the effectiveness of sustainability initiatives may depend on contextual factors such as the firm size, industry dynamics and market conditions [3], [5], [7], [11]. Also, a lot of the current literature has been based on developed economies and a significant amount of empirical evidence on competitive environments where firms experience unique constraints and opportunities remains limited.

It is against this backdrop that the present study tries to quantify sustainable business practices in the context of ESG metrics and tries to analyze their effects on the financial performance of business in competitive markets. In particular, the research aims to explore the impact of ESG dimensions on financial performance and which of its components has the strongest impact. By achieving these aims, the study has provided contributions to the body of knowledge that already exist by providing empirical data regarding the ESG-financial performance relationship, developing a composite ESG measurement framework, and giving managers and policymakers some insights on how to leverage sustainability as a strategic driver of financial success. The rest of this paper is structured into parts that discuss literature review, conceptual framework and hypotheses, methodology, results, discussion and conclusion.

## 2. LITERATURE REVIEW

The theoretical viewpoints that have been well established form the basis of the relationship between sustainable business practices and financial performance; specifically, stakeholder theory and resource-based view (RBV). Stakeholder theory is an idea that suggests that companies that are successful in meeting the interests of various stakeholders, such as customers, employees, investors, and society are more likely to achieve long-term success and enhanced financial performance. In that regard, ESG practices can help to increase the level of transparency, trust, and corporate legitimacy which may be reflected in the high performance of a firm. To supplement this, the resource-based view holds that sustainability-related capabilities, including effective resource use, development of green technologies, and good governance systems, can be valuable resources that are rare and difficult to imitate and provide a competitive edge. All these theoretical underpinnings therefore explain why companies who invest in sustainability programs can over time have better financial performance.

Empirical research has furnished a significant amount of empirical evidence that has investigated the association between sustainability practices and profitability. Some studies have found the positive association that indicates that companies that have adopted sustainable practices are more likely to be more profitable, more efficient in operations and less exposed to risk. As an example, the extensive reviews and meta-analyses serve as compelling evidence of the positive correlation between the ESG performance and the financial one across various industries and regions [4], [12]. In the same way, studies that have concentrated on sustainability practices point at the fact that they have the potential of increasing the long-term firm value and competitiveness, though with some differences depending on measurement approaches, and contextual factors [3], [5].

Recent empirical works have also further examined the effects of the ESG dimensions on firm performance through the use of higher levels of methodology and a variety of data. There is evidence that the ESG practices can have a beneficial effect on the financial indicators, i.e. ROA and ROE, the cost of capital and the efficiency of the resource's allocation [1], [6], [8], [9]. Also, the association between ESG practice and financial performance has been observed to be strengthened with technological change and integration of Industry 4.0 that suggests sustainability and technological advancement can co-evolve to improve business performance [2]. Nevertheless, other researchers point to the fact that the correlation might be conditioned by company-specific variables, disclosure policies, and other externalities including media exposure and market conditions [7], [10], [11].

Even amid the increasing body of research, there is still a significant gap in the knowledge of the ESG - financial performance relationship and the competitive market environment, especially in developing economies. The available literature is mostly based on developed countries, where the regulating frameworks of the market, their maturity and awareness of the stakeholders are very different in developed countries as compared to in emerging markets. More so, previous research frequently presents mediocre or inconclusive outcomes, indicating that the effects of sustainability practices might be different in accordance with the dynamics in industries, size of a firm and the intensity of competition. Hence, more empirical studies are required that combine ESG-measures with financial performance measures in a competitive environment. To close this gap, the current research is important as it would help to identify the relationship between sustainable business practices and financial performance using ESG-based measures, which would provide a deeper insight into the way sustainability could be used as a strategic driver of profitability in the competitive market.

## 3. Conceptual Framework and Hypotheses

The rationale behind the development of the conceptual framework of this research is to assume that sustainable business practices, as represented by the environmental, social, and governance (ESG) dimensions, have a significant influence on the financial performance of firms. Based on the resource-based view and stakeholder theory, ESG practices can be regarded as strategic assets that boost the efficiency, reputation, and trust of stakeholders of an organization, thus contributing to the enhancement of the financial results. Practices that can be implemented to reduce operational costs and regulatory risks include environmental practices such as efficient use of the resources at hand and reduce emission levels. The stakeholder relationships can be enhanced and the productivity can be improved by means of social practices such as the employee welfare and the corporate social responsibility programs. The quality of decision and investor confidence are boosted by practices of governance, including transparency and effectiveness of boards. All these dimensions combine to create a holistic ESG framework which is likely to have a positive impact on the financial performance indicators like Return on Assets (ROA) and Return on Equity (ROE), as empirically supported by previous empirical studies [1], [4], [6], [12].

On the basis of these theoretical and empirical implications, the study postulates a conceptual model where ESG practices serve as an independent variable that impacts on financial performance as the dependent variable and the firm-specific factors such as size, leverage, and industry type are treated as control variables. The suggested framework is presented in Figure 1 which shows a direct correlation between the dimensions of the ESG and the outcomes of the financial performance. The model presumes that individual and collective contributions of each of the ESG components contribute to the profitability of the firm, and thus this provides a more structured basis on which hypotheses are developed.

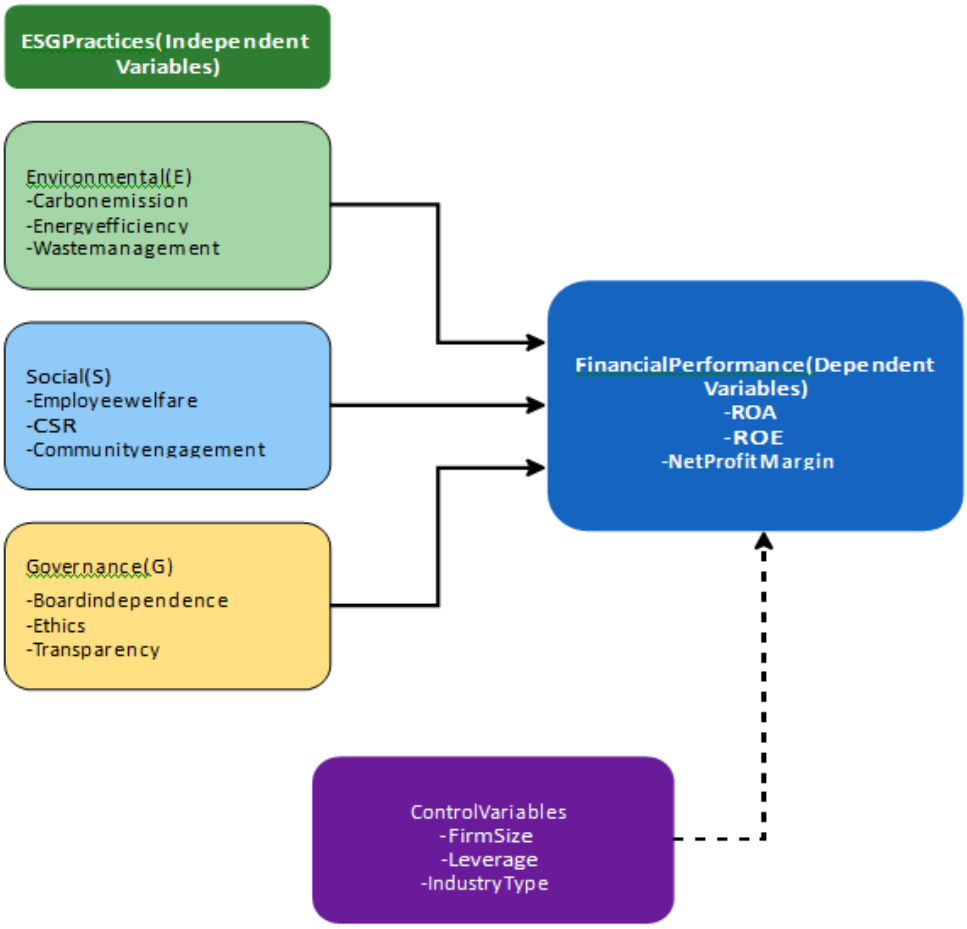



**Fig. 1.** Conceptual Framework Diagram

Based on the conceptual framework of Fig. 1, empirical testing hypotheses are:

H1: The environmental practices have a positive impact on financial performance.

H2: There is a positive influence of social practices on financial performance.
H3: The governance practices have positive influence in the financial performance of the business.
H4: The total ESG scores have a positive effect on financial performance.

## 4. METHODOLOGY

### 4.1 Research Design

The research design in this paper is the quantitative research design because it seeks to empirically investigate the association between sustainable business-related practices and financial performance in the competitive market environments. The quantitative methodology is suitable because it enables testing of hypotheses based on measurable variables, like ESG indicators and financial ratios. The research is cross-sectional, which means that data is gathered over a certain time frame and across various companies and allows comparing the ESG performance and financial outcomes of different firms in the same market. In multi-year data, the analysis can be generalized to a panel format to allow analyzing time-related variations and enhance the robustness. The research can be described as explanatory in nature, as it was based on a need to identify a causal relationship between ESG practices as independent variables, and financial performance as a dependent variable.

### 4.2 Data Collection

The research employs secondary data gathered by corporate annual reports, sustainability reports and established ESG databases. These sources are credible and standardized data on sustainability practice as well as financial performance that ensure that data is identical across observations. The sample is formed of the firms that work in the competitive industries and are selected according to the availability of the ESG disclosure and full financial data. A purposive sampling methodology is used to sample only those firms which satisfy the study criteria, thus improving data quality and relevance. The sample includes companies across various industries, which implies that the results can be more widely applicable. The information about the number of firms, distribution of firms within the industry and the period of observation are summarized in Table 1, which gives an overview of the sample characteristics to be used in the analysis.

**Table 1.** Sample Description of Firms Included in the Study

| Category | Description | Value |
|---|---|---|
| Number of Firms | Total number of firms included in the sample | 120 |
| Industry Sectors | Types of industries represented | Manufacturing, Services, Energy, IT |
| Time Period | Duration of the study (years) | 2019–2023 |
| Total Observations | Number of firm-year observations | 600 |
| Data Source | Source of data (e.g., reports, databases) | Annual Reports, ESG Databases |
| Sampling Technique | Method used for selecting firms | Purposive Sampling |
| Market Type | Nature of market | Competitive Industries |

### 4.3 Variables and Measurement

The variables in this study can be categorised into independent, dependent and control variables to ensure a systematic empirical study. ESG metrics operationalize sustainable business practices and include environmental, social and governance dimensions. The environmental performance uses such indicators as carbon emissions intensity, the efficiency of energy use, and waste management as the measure of the ability of a certain firm to decrease the environmental impact and achieve high efficiency of energy use and waste disposal. Social performance measures things to do with the welfare of employees, activities conducted by the company as part of the corporate social responsibility, and activities conducted by the company to relate to the welfare of its local communities. Governance performance is concerned with the quality of internal management and oversight mechanisms, captured by board independence, ethical policies, and transparency in reporting, which in turn, enhances decision-making and accountability. These three dimensions are summed up in order to come up with a composite ESG score which reflects the overall degree of sustainable business practice that a firm has adopted.

The metrics used to measure financial performance are accounting-based measures and they include Return on Assets (ROA) and Return on Equity (ROE) which are the measures of efficiency of asset utilization and the profit generated to shareholders respectively. Moreover, it can be accompanied by Net Profit Margin as a supplementary measure in order to embrace the general profitability. The research uses firm size, leverage, and industry type as control factors to control external influences on financial performance. The size of a firm is measured using the natural logarithm of total assets, leverage is

measured as the ratio of total debt to total assets and finally an industry type is included as a categorical variable to account industry differences. Table 2 with a comprehensive overview of all variables, their definition, and methods of measurement, is in itself clear and consistent in operationalizing constructs.

**Table 2.** Definition and Measurement of Variables Used in the Study

| Variable Category | Variable Name | Symbol | Measurement / Proxy | Description |
|---|---|---|---|---|
| Independent | ESG Composite Score | ESG | Aggregated index (E + S + G) / 3 | Overall sustainability performance combining environmental, social, and governance factors |
| Independent | Environmental Score | E | Standardized score based on emission, energy, waste indicators | Measures firm's environmental practices and impact |
| Independent | Social Score | S | Index based on CSR, employee welfare, community engagement | Reflects firm's social responsibility and stakeholder engagement |
| Independent | Governance Score | G | Index based on board structure, ethics, transparency | Captures corporate governance quality |
| Dependent | Return on Assets | ROA | Net Income / Total Assets | Measures efficiency of asset utilization |
| Dependent | Return on Equity | ROE | Net Income / Shareholders' Equity | Measures return generated for shareholders |
| Dependent (Optional) | Net Profit Margin | NPM | Net Profit / Total Revenue | Indicates overall profitability |
| Control | Firm Size | SIZE | Natural Log of Total Assets | Represents scale of firm operations |
| Control | Leverage | LEV | Total Debt / Total Assets | Indicates financial risk level |
| Control | Industry Type | IND | Dummy variable (1 = Industry, 0 = otherwise) | Controls for sector-specific effects |

### 4.4 Data Analysis Techniques

The analysis takes the form of an integration of statistical analysis to get a rigorous analysis of the proposed relations. The initial use of the descriptive statistics is to summarise the data and give an overview of the distribution of all the variables including mean, standard deviation and range. This will be followed by correlation analysis that will determine the strength and direction of the relationship between ESG components and financial performance indicators. In order to test the study hypotheses, multiple regression analysis is used in an attempt to assess the effects of ESG practices on financial performance holding constant the effects of firm size, leverage and industry effects. The regression model can determine the degree in which changes in ESG scores can help explain variations in financial performance across firms. In some instances, higher order analytical models like panel regression models, or Structural Equation Modeling, may be employed to increase the strength of the results and serve more intricate relationship models among variables. All these methods can guarantee the validity, reliability and generalizability of the study results.

## 5. RESULTS

### 5.1 Descriptive Statistics

The descriptive statistics give an idea about the distribution and central tendencies of the variables utilized in the research. The mean, standard deviation, minimum, and maximum values were examined in order to determine how much the ESG scores and financial performance indicators of different firms vary. The findings in Table 3 show that the ESG composite score is moderately varied which means that firms differ in the embrace of sustainable business practices. They also exhibit variability in financial performance indicators, such as Return on Assets (ROA) and Return on Equity (ROE). In general, the descriptive analysis proves the suitability of the data set to be further tested statistically and tested with respect to hypothesis.

**Table 3.** Descriptive Statistics of Variables

| Variable | N | Mean | Std. Deviation | Minimum | Maximum |
|---|---|---|---|---|---|
| ESG Score (ESG) | 600 | 0.62 | 0.15 | 0.30 | 0.90 |
| Environmental (E) | 600 | 0.60 | 0.18 | 0.25 | 0.92 |
| Social (S) | 600 | 0.65 | 0.14 | 0.35 | 0.88 |
| Governance (G) | 600 | 0.63 | 0.13 | 0.40 | 0.91 |
| Return on Assets (ROA) | 600 | 0.085 | 0.040 | 0.010 | 0.180 |
| Return on Equity (ROE) | 600 | 0.145 | 0.070 | 0.020 | 0.300 |
| Net Profit Margin (NPM) | 600 | 0.120 | 0.055 | 0.015 | 0.250 |
| Firm Size (SIZE) | 600 | 15.20 | 1.10 | 12.50 | 18.30 |
| Leverage (LEV) | 600 | 0.48 | 0.20 | 0.10 | 0.85 |

### 5.2 Correlation Analysis

Figure 2 depicts a relationship between the ESG composite score and financial performance, in terms of Return on Assets (ROA), in a scatter plot with a regression line fitted to it. The data points plotted are the level of firm observation, where the ESG scores range within 0.30 and 0.95, and the ROA values are between 0.01 and 0.18. The point distribution clearly indicates an upward trend and this implies that companies with higher ESG represent higher levels of ROA.

The positive relationship is also supported by the fitted regression line which can be expressed as following:

ROA = 0.018 + 0.107 × ESG.

This means that an increase in the ESG score in one unit is, other things held constant, associated with an increase in the ROA in the same unit; 0.107 (10.7%). Though ESG values are along a normalized scale (0 to 1), even small improvements in the ESG performance are associated with significant monetary efficiency.

The coefficient of determination ($R^2$ = 0.392) indicates that approximately 39.2% of the variation in ROA can be explained by ESG performance. This indicates a moderate explanatory power, indicating that although ESG is a key determinant of financial performance, other factors like the size of firms, leverage, and industry characteristics also contribute.

Also, the relationship is significant and has been reported to be of less than 0.001 indicating strong evidence against the null hypothesis of no relationship. The reliability of the results is also enhanced by the fact that the sample size is N = 600 observations.

Comprehensively, Figure 2 shows that there is a positive statistically significant linear relationship between ESG performance and ROA. The positive slope of the regression line, as well as the concentration of the data points along the regression line, confirm that the upward slope of the regression line is more likely to be used up by the data points and hence result in higher profitability.

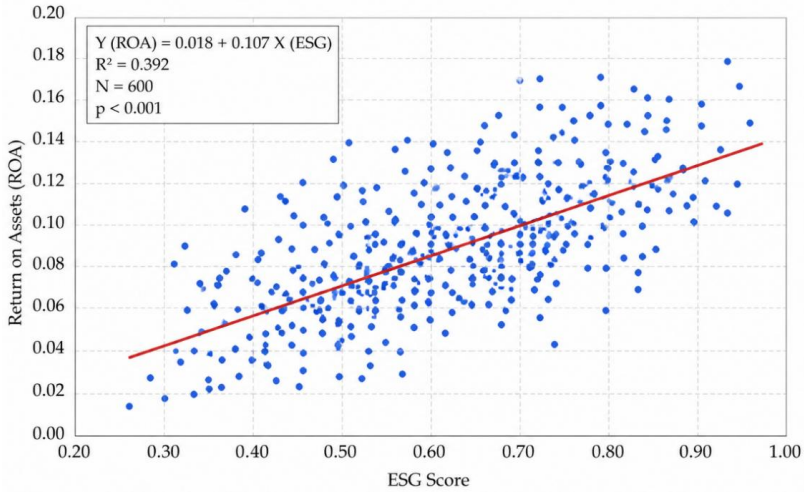



**Fig. 2.** Scatter Plot Showing the Relationship Between ESG Score and Return on Assets (ROA)

### 5.3 Comparative Analysis of ESG Components

In Figure 3, a comparative analysis of the average impact of the three ESG components; Environment (E), Social (S) and Governance (G) on the financial performance by using Return on Assets (ROA). The findings explicitly show that there is a difference in the magnitude of influence on the three dimensions. Particularly, the highest average ROA value of 0.128 is portrayed by the Governance (G) component, followed by the average ROA value of

the Social (S) component, which is 0.093, and the Environmental (E) component with the lowest average ROA value of 0.081.

These quantitative distinctions imply that governance practices have the largest impact on the profitability of firms under the three ESG dimensions. The relatively high ROA value related to governance means that firms with effective governance structures, i.e. effective board independence, transparent reporting systems, and effective ethical policies possess a better position to use their assets in an efficient manner and yield higher returns. This helps in the argument that quality and accountability mechanisms in the internal management are critical in driving financial performance.

Comparatively, the social aspect, a mean ROA of 0.093, has an intermediate positive role on financial performance. This means that better stakeholder relationships would be enjoyed by the firms that invest in employee welfare, corporate social responsibility (CSR) and community engagement, which in turn can translate to better productivity and brand reputation which ultimately can affect profitability.

The environmental dimension, despite a positive association with the financial performance, presents the lowest average value of ROA, which is 0.081. Here, it implies that although environmental practices like energy efficiency, emission reduction, and waste management are associated with the saving of cost and improving operations; the financial benefits of these strategies may not be able to materialize as compared to governance and social initiatives.

Generally, the findings illustrated in Figure 3 confirm the fact that, although all ESG elements have a beneficial influence on the financial performance, the governance practices have the most significant and immediate impact followed by social and environmental factors. This underlines the need to focus on the efficacy of effective governance structures coupled with sustainability efforts as a means of realizing high financial performance in competitive markets.

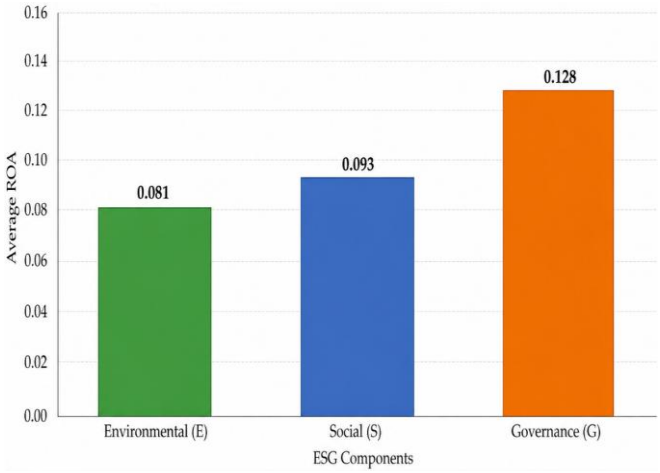



**Fig. 3.** Comparative Analysis of Environmental, Social, and Governance (ESG) Components on Financial Performance (ROA)

### 5.4 Regression Analysis

The analysis is done using multiple regression analysis to determine the effect of ESG practices on financial performance and control the effect of firm size, leverage and type of industry. The regression findings have shown that the ESG composite score positively affects both ROA and ROE and the effect is statistically significant. The research implication of this finding is that companies with greater degrees of sustainability practices are more likely to attain better financial performance. Of the individual ESG items, governance has the highest and most important coefficient showing its pivotal value in increasing firm profitability. There are also positive impacts on the environmental and social dimensions, although the degree of impact differs between models which are specified differently.

### 5.5 Hypothesis Testing Outcomes

According to the results of the regression, all the suggested hypotheses are accepted. The positive influence of environmental practices on the financial performance in support of H1 is found. The social practices also indicates a positive correlation with the financial performance, which confirms H2. The evidence of the significant and statistically significant impact of governance practices on financial performance supports H3. Lastly, financial performance is positively linked with overall ESG composite score, which supports H4. Based on these findings, the necessity to incorporate ESG practices into business strategies is justified, especially in the competitive markets

where sustainability can become one of the main promulgators of business success.

## 6. DISCUSSION

The results of the current study are a clear testament to the fact that sustainable business practices, in terms of their measurement based on the ESG indicators, have a positive and significant effect on the financial performance of the businesses that operate in the competitive market. The findings suggest that companies with better ESG scores are more likely to be profitable, in terms of higher Return on Assets (ROA) and Return on Equity (ROE). This implies that sustainability is not just a compliance or ethical issue but a strategic one that helps in the achievement of operational efficiency, risk management and long-term value generation. The positive relationship realized in the analysis implies that the firms, which implement environmentally responsible practices, engage in social initiatives and have good governance structures are in a better position to optimize resources and improve overall performance.

The analysis also indicates that out of all the ESG aspects, the governance practices have the greatest impact on financial performance. This result indicates the significant importance of transparency, accountability, and effective decision-making in success of firms. Positive contributions are also reflected in terms of environmental and social practices, but the impact of these practices is relatively moderate. Environmental programs help save costs and efficiently use resources, and the social practices enhance the relationships of the stakeholders and the reputation of the companies themselves. These findings are consistent with the idea that an equal combination of ESG elements is crucial to attaining sustainable financial results.

The results are mostly similar to the existing literature that indicates a positive correlation between ESG performance and firm profitability. Previous empirical and meta-analytical research has also reached the same conclusion that sustainability practices are able to improve financial performance by increasing efficiency and decreasing risks. Nonetheless, this work builds on previous studies by applying the analysis specifically to competitive market settings, in which companies are more under pressure to innovate and differentiate. Some of the past research have indicated mixed or contingent results which prove the presence of the positive relationship between ESG and financial performance in a competitive environment. The current findings however are more convincing in proving the existence of the positive relationship between ESG and financial performance in a competitive environment.

These findings have their implication on competitive firms operating in competitive markets. To begin with, organizations must think of how to incorporate the ESG practices in their main business strategies and not to regard them as peripheral operations. Second, the priority should be given to strong governance mechanisms that seem to make the most significant contribution to the financial performance. Third, companies ought to develop a global sustainability strategy, which entails balancing environmental, social and governance programs to maximize their overall benefits. In so doing, firms are able to increase their competitiveness, draw investment, and attain long-term financial success. Generally, the research highlights the significance of sustainability as a major source of firm performance in an environment conducive to business.

## 7. CONCLUSION

In this research, we explored the connection between sustainable business practices and financial performance in competitive markets using ESG-based measures. The results are a solid evidence that the positive and statistically significant effect of ESG practices on the financial performance of firms is positive and statistically significant and, in particular, as measured by the Return on Assets (ROA) and Return on Equity (ROE). Companies that practice environmental, social and governance activities are more likely to experience better profitability and operating efficiency than that of companies with lower levels of sustainability engagement. The dimension of governance practices are found to have the largest impact on the financial outcomes, followed by environmental and social factors, and this highlights the importance of effective management structures and transparency in driving firm performance.

The study also adds to the theory by helping to reaffirm the applicability of the stakeholder theory and resource based view in explaining the relationship between sustainability and financial performance. It proves that ESG practices could be discussed as strategic resources which help to raise the competitiveness of firms and generates the long-term value. Additionally, the research presents the gap in previous literature by offering empirical data of ESG-financial performance at competitive market conditions, thus extending the knowledge of ESG-financial performance relationships beyond the traditional settings.

From a practical perspective, the findings offer valuable insights for managers, investors, and policymakers. Companies are advised to include ESG practices in their major strategic decision

making processes as opposed to considering them as an additional move. It should be focused on reinforcing the mechanism of governance and adopting a balanced approach both on the environmental and social front. These lessons are also applicable in influencing policymakers to target the ESG disclosure standards and regulations that are sustainability oriented. In general, the paper emphasizes that sustainable business practices are not only morally acceptable but also financially viable, as one of the prime factors of long-term financial success in competitive markets.

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