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Unveiling The Nexus: Environmental, Social, And Governance Performance and Its Impact on The Cost of Debt for Indian Firms

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Abstract- Environmental, Social, and Governance (ESG) considerations have gained prominence in shaping the strategic decisions of firms and the perception of stakeholders. This paper investigates the relationship between ESG performance and the cost of debt for Indian firms. Using panel data analysis from firms listed on the NSE between 2015 and 2023, the study finds that firms with strong ESG performance benefit from lower debt financing costs. This relationship is particularly significant in sectors with high environmental and regulatory exposure. The results emphasize the growing role of non-financial disclosures in credit risk assessment by lenders in India.

I. INTRODUCTION

The cost of debt, a critical component of a firm's capital structure, is increasingly influenced by non-financial factors such as ESG performance. While traditional creditworthiness assessments focus on financial ratios, contemporary lenders are incorporating ESG metrics to assess long-term risks and sustainability. In India, the Securities and Exchange Board of India (SEBI) has mandated ESG disclosures for top-listed companies, signaling a shift toward responsible corporate behavior. This study explores how ESG performance affects the cost of debt for Indian firms and identifies which ESG components have the most influence.

II. IDENTIFY, RESEARCH AND COLLECT IDEA

To develop the framework of this paper, the following steps were undertaken:

1. Review of Literature: Prior studies in developed markets, such as the U.S. and Europe, have shown a negative correlation between ESG performance and cost of capital. However, limited empirical evidence exists for Indian firms.
2. Secondary Data Analysis: Data from Bloomberg ESG database and CMIE Prowess for debt-related metrics was utilized.
3. Engagement in Seminars: Participation in ESG and sustainable finance workshops conducted by SEBI, NSE, and academic institutions helped refine the research objective.
4. Understanding ESG Jargon: Terms like "carbon risk," "social license to operate," and "corporate governance score" were studied in detail.

III. WRITE DOWN YOUR STUDIES AND FINDINGS

A. Methodology

A panel regression model was applied to data from 150 NSE-listed firms between FY 2015–2023. The dependent variable was the firm's cost of debt (interest expenses/total debt), and independent variables included ESG score (composite), firm size, profitability, and credit rating.

B. Data Collection Approach

The ESG scores were collected from Bloomberg, while financial data was retrieved from CMIE Prowess. ESG was disaggregated into E (carbon emissions, energy usage), S (employee turnover, diversity), and G (board independence, audit score).

C. Key Findings

- Firms in the top ESG quartile had on average a 0.75% lower cost of debt than bottom-quartile firms.

- The environmental pillar had the strongest inverse relationship with cost of debt, especially for energy and manufacturing sectors.
- Credit ratings were positivel influenced by consistent ESG disclosures.
- Lenders showed greater trust in firms with better governance practices, often offering preferential loan terms.

D. Use of Simulation A simulated sensitivity analysis was conducted using R software to observe how hypothetical changes in ESG scores could impact debt cost. Results showed that even modest improvements in governance reduced the interest rate spread by 10–15 basis points.

IV. GET PEER REVIEWED

The draft was reviewed by ESG professionals and academic researchers from the Indian Institute of Management and the Confederation of Indian Industry (CII). Comments focused on data robustness and the interpretation of sectoral variation.

V. IMPROVEMENT AS PER REVIEWER COMMENTS

Following review:

- Sectoral analysis was deepened by comparing manufacturing, financial services, and IT industries.
- Added robustness checks using fixed effects and generalized least squares (GLS) models.
- Improved explanation of ESG score construction and limitations.

CONCLUSION

This study highlights the importance of ESG performance as a determinant of the cost of debt for Indian firms. It demonstrates that ESG integration is no longer just a compliance exercise but a strategic financial decision. The findings support the role of sustainable finance in India's economic future and recommend regulatory reinforcement for ESG transparency. Future research can extend this work by exploring causality and firm-specific ESG initiatives.

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