Strategies and Considerations for Enterprises to Balance ESG in the Context of an Economic Downturn

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Abstract. With the global economic situation complicating and China's economic growth slowing, companies are facing challenges. At this period, ESG investing becomes increasingly important. Considering such a special period, this research aims to explore how companies can balance ESG strategies during economic downturns. Through qualitative analysis, the paper analyzes A-share listed companies' financial performance under economic downward pressure. The paper also discusses how ESG investment effects corporate costs and discusses the advantages, disadvantages, opportunities and threats of investing ESG. The study found that while ESG investments may increase the financial burden on companies in the short term, they will bring significant economic benefits to companies in the long run. This study suggests that companies should adopt a flexible ESG strategy like prioritizing investments in ESG projects with high returns, using cost-benefit analysis to evaluate potential ESG investments, as well as adopting incremental ESG strategy improvements. In addition, enterprises should be in line with their actual conditions to make ESG strategies. Ultimately, this study offers practical advice on the strategies companies can employ to enhance competitiveness and achieve long-term sustainability during economic downturns.

1 Introduction

Today's international atmosphere is becoming more complex and severe. As a result, the downward pressure on the Chinese economy is continuously increasing under the both pressures of internal and external factors. After 2010, China's economic development has been basically below the double-digit high-speed growth stage. Meanwhile, it has entered a period of continuous economic downturn with fluctuations downward. In the first half of 2022, China's economic slowed to 2.5%. It indicates that the downward pressure on the economy has begun to expand into various fields. In the future, the pressure on the real economy will further increase because of the decline in inflation and the tightening of financial condition. Various signs indicate that China's economy may face the potential risk of recession. Meanwhile, as the development of China's economy, more and more environmental problems have occurred. Chinese government has put more attention and

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effort on this issue to urge the market and enterprises to make green transformation. Under proper policy guidance, China's green finance and ESG scoring system have developed rapidly. What's more, emphasis on corporate ESG information has been continuously increased. More and more enterprises are choosing to invest in ESG and improve ESG disclosure.

There have been a lot researches highlighting the favorable outcomes of ESG on the company's diverse areas. Hong and Chen used empirical analysis to confirmed that company's ESG performance stimulates its sustainable development. This effect is transmitted through a complete mediating effect of external attention to the market [1]. Shi et al. used regression analysis to introduce ESG's green and innovation effects. The research revealed that the company with better ESG performance can more effectively enhance its innovation ability and green effect. Then, it can promote the improvement of corporate performance [2]. Xie used the mediation effect model to explore how ESG performance influences companies' stock price fluctuations. The research found that the listed companies will get better reputation if they improve their ESG performance. Then, they can curb stock price fluctuation. The research also found that listed companies can reduce corporate financial risks by improving ESG performance and curb stock price fluctuation [3]. Yu et al. used a benchmark regression model to validate corporate ESG performance mainly promotes corporate value enhancement through increasing corporate investment in innovation and obtaining tracking by analysts. In addition, the corporate innovation investment and external analysts' attention are synergistic. The research also found that ESG fund holdings have a supportive moderating influence on the bond between corporate ESG performance and company value [4]. Huang et al. used the manufacturing enterprises as a research sample and established a panel two-way fixed effect model to test the influence and mechanism of ESG ratings on the innovation level of manufacturing enterprises from a micro standpoint. This research found that good ESG performance can effectively foster increased innovation in manufacturing firms through more media attention and government subsidies [5]. Lai et al. used empirical analysis and found that corporate ESG ratings contribute positively to corporate resilience especially in an environment of high economic policy uncertainty. Among ESG's three dimensions, corporate governance improves corporate resilience most considerably [6]. Zhang et al. found that ESG performance can significantly improve stock liquidity and society has the most important effect on it. The research also found that the effect on non-heavy polluting enterprises and state-owned enterprises is more obvious [7]. An et al. integrated the data of Chinese customs enterprises and A-share listed companies from 2009 to 2016 and combined them with the ESG scores under the China Securities evaluation system. The research systematically examined how ESG performance influences the export effectiveness of listed enterprises and showed that it can effectively promote the expansion of corporate exports [8]. Li and Zhou revealed that companies with good ESG performance can markedly decrease the credit spread of listed corporate bonds. The research used the intermediary response model and found the performance of enterprises will reduce the credit spread of bonds by reducing the information asymmetry between investors and enterprises [9]. Zhao et al. examined how corporate ESG performance affects its equity capital cost. Research used a variety of risk indicators to test the mechanism of the above impact from the perspective of corporate risk and conducted heterogeneity analysis at different levels. The results demonstrate that companies with better ESG performance can lower the financing costs by reducing corporate risk [10].

The main focus of this study is to explore the strategies and considerations for enterprises to balance ESG during economic downturn. This study will apply qualitative analysis and analyze complex interplay between ESG investment and corporate development strategies during economic downturns. The findings aim to offer practical insights for corporate managers on the strategic management of ESG investment to support sustainable business practices.

2 The current situation of listed companies under the downward trend of the economy

2.1 An overview of the performance of A-share market

Overall, in the first half of 2024, 5,346 A-share listed companies achieved a total operating income of 34.87 trillion yuan, marking a 1.41% drop from the previous year. Additionally, the total net profit for the parent company amounted to 2.90 trillion yuan, indicating a 2.36% decline year over year. A-share listed companies are facing certain downward pressure in the first half of 2024. In terms of sub-sectors, the net profit attributable to the parent company of all listed sectors decreased year-on-year. While most companies are profitable, overall growth is under pressure [11].

2.2 An overview of the performance of the A-share industry

In terms of industry revenue growth, 13 of the 27 Dongcai first-class industries have negative growth rates. The revenue growth rates of real estate, comprehensive, building materials, and trade and retail industries are all lower than -10%. Real estate even reached -21.36%[11].

In terms of net profit growth, the net profit growth rate of the real estate industry fell by more than 100% year-on-year, agriculture, forestry, animal husbandry and fishery decreased by more than 200%, and electrical equipment, iron and steel, and building materials all fell by more than 50% [11].

At the beginning of 2024, the volcanic industry is facing the dual pressure. As a result of the ongoing decrease in prices in the industrial chain, especially the sharp decline in the prices of polysilicon, wafers, cells and modules, enterprises have started to sell at a loss. Therefore, their profits have decreased significantly. This has led to pressure on the industry's performance. More than two-thirds of photovoltaic companies have experienced negative net profit growth, with a total loss of 17.2-21.4 billion yuan. Enterprises are generally faced with problems such as insufficient operation, inventory impairment and fixed asset impairment. Some enterprises have even been delisted or bankrupt [12].

Many real estate companies in the real estate industry have suffered losses too. Some companies are even facing overdue debts and bankruptcy restructuring. According to the statistics of China Real Estate News, among the 72 A-share listed real estate companies that have released the performance forecast for the first half of 2024, 47 real estate companies have a loss in net profit attributable to the parent company, accounting for more than 60 percent. The estimated loss is 27.478 billion yuan ~ 34.885 billion yuan[13]. Factors such as declining sales performance, provision for impairment losses, and high land costs are the primary factors contributing to the losses of real estate firms. The plight of these industries reflects companies are facing challenges under downward pressure on the economy.

3 Analysis of ESG demand for corporate investment

3.1 The impact of ESG on the costs and benefits of a business

From an environmental perspective, investments in environmental technology, clean energy, waste management, and pollution control increase direct cost. But in the long run, these investments can reduce fines for environmental violations and improve resource efficiency. Thereby, they will reduce costs and potentially increase revenues.

From a societal perspective, investing in employee well-being, health and safety, community engagement, and supply chain responsibility increases costs. However, it can also improve employee satisfaction and productivity, reduce employee turnover, and strengthen brand reputation. Then, it can potentially increase customer loyalty and market share.

From a governance perspective, a good corporate governance structure, such as a transparent decision-making process, effective board operations, and shareholder rights protection, can make many advantages. For example, they can reduce opportunistic behavior by management, reduce agency costs, and improve corporate transparency and investor confidence. These may lower the financing costs and boost the company's market valuation.

3.2 Strength and weakness of investing in ESG

3.2.1 Strengths

Firstly, with the global emphasis on sustainable development, governments and regulators are introducing more policies and regulations to support ESG investment. For example, China's promotion of the improvement of ESG system under the "dual carbon" goal provides policy incentives and guidance for enterprises. What’s more, ESG investing has become an important part of the global financial market. Investors are more willing to invest companies with good ESG performance. It provides additional financing opportunities and market competitiveness for companies. Meanwhile, technological means, such as artificial intelligence and big data, are being applied to ESG practices to help companies manage and report ESG-related data more effectively. They improve efficiency and transparency.

3.2.2 Weaknesses

In the short term, companies may need to invest additional funds to improve their ESG performance. It may put pressure on corporate financial position. Secondly, companies may face challenges in ESG disclosure, including how to accurately measure and report ESG-related metrics, and how to ensure the quality and credibility of the information disclosed. Last but not least, there is a relative shortage of professionals in the ESG field. Companies may need to invest resources in training and recruitment to build a professional ESG team.

3.3 Opportunities and threats for companies to invest in ESG

3.3.1 Opportunities

Investors are inclined to pay extra for companies that have a strong ESG performance. Companies can obtain lower financing costs by improving ESG performance. What’s more, enterprises can enhance brand value and consumer trust through ESG practices. Thereby, they can gain better positioning and higher market share in the market. ESG practices can also help companies better identify and manage environmental, social, and governance-related risks and then improve their long-term stability and sustainability.

3.3.2 Threats

As more and more companies begin to focus on ESG, market competition is intensifying. Companies need to continuously innovate and improve their ESG practices to remain competitive. Meanwhile, the policy environment is subject to change. Companies need to keep a close eye on policy developments to ensure that their ESG practices are aligned with the latest regulations and standards. Businesses may be also at risk of being accused of "greenwashing". Ostensibly supporting ESG but not actually taking substantive action could damage the company's reputation.

4 Recommendations and prospects

4.1 The challenges faced by businesses during the economic downturn and the help of ESG strategies

An economic downturn could have a negative effect on consumer purchasing power and cause a shrinking market. Companies can enhance consumer trust and loyalty by strengthening social responsibility(S) practices. For example, they can improve product and service quality, enhance customer service, and build brand image through sustainable marketing strategies.

Economic pressures could also lead to higher funding costs and lower investor and creditor confidence. Companies with high ESG ratings are generally considered to have less systemic risk exposure, less frequent special controversy events, and higher profitability and dividend payment ability. As a result, they are more likely to enhance investor confidence. Therefore, they can obtain high valuation and financing opportunities. It can positively contribute to their stock price and market value management.

Another challenge caused by economic downturns is volatile resource prices and supply chain disruptions. It can lead to significant cost increases. To effectively address these challenges, companies can adopt ESG strategies such as implementing energy-efficient technologies and circular economy models. By adopting energy-efficient technologies, companies can reduce their dependence on energy and reduce energy consumption. Thereby, they can keep costs stable when energy prices fluctuate. At the same time, the circular economy model emphasizes the maximization of resources and the minimization of waste. This strategy not only helps companies reduce their sensitivity to fluctuations in the raw material market, but also reduces long-term resource procurement costs through recycling and reuse.

The challenge of supply chain disruptions can be addressed by strengthening corporate governance (G) practices. For example, companies should actively seek out multiple suppliers to reduce reliance on a single supplier. In this way, if one supplier is unable to supply for any reason, the company can quickly switch to another supplier. This ensures continuity of production and operations. And companies should have a long-term and stable relationship with their suppliers. It will help them get priority support from their suppliers when supply chain disruptions. Long-term partnerships also encourage suppliers to improve their own ESG performance in order to maintain relationships with companies. Moreover, companies should incorporate ESG criteria into the supplier selection and evaluation process. This includes an assessment of the supplier's environmental management, social responsibility and corporate governance to ensure their supplier's operations meet the requirements of sustainable development. Through these strategies, companies can improve the resilience and stability of their supply chains. They can also remain competitive during economic downturns while laying the foundation for long-term sustainability.

4.2 Flexible ESG strategies

In view of the increased costs of ESG investment in enterprises during the economic downturn, this paper argues that enterprises should adopt flexible ESG strategies. Companies should prioritize investing in ESG projects with high returns. Companies should identify ESG projects that deliver significant environmental and social benefits while delivering high economic returns. For example, investing in energy efficiency projects often reduces energy consumption and costs and improve the financial performance of a company. Companies should also prioritize resources allocated to those that have the most impact and return by assessing the long-term value and cost-saving potential of different ESG projects.

Companies should use cost-benefit analysis to evaluate ESG investments. For any potential ESG investment, companies should conduct a detailed cost-benefit analysis to consider direct costs, indirect costs, potential risks, and long-term benefits. Through this analysis, companies can quantify the financial impact of ESG investments and ensure that investment decisions are aligned with the company's financial goals and strategic planning. Also, companies can take a step-by-step approach. They can start with easy-to-implement and lower-cost ESG measures and gradually transition to more complex projects. This approach helps companies gradually improve their ESG performance without adding too much burden.

What’s more, the impact of ESG scores on companies varies depending on their industry, size, region, and nature of the business. Therefore, business managers should measure ESG according to their own situation. For example, resource-intensive industries such as energy, minerals, and manufacturing, where the performance of these industries in terms of environment (E) influences corporate overall ESG score more greatly. Fluctuating resource prices and supply chain disruptions can lead to increased costs for businesses in these industries. So, implementing an effective ESG strategy is essential to improve resource efficiency and reduce environmental risks. Highly polluting industries such as chemicals, paper and smelting, whose investment in environmental remediation and pollution control directly affects their ESG scores. In times of economic downturn, these companies may face stricter environmental regulations and higher compliance costs. So, strengthening ESG practices is particularly important to reduce potential legal risks and enhance corporate image. Labor-intensive industries such as textiles, apparel, and services, where corporate performance in terms of social responsibility (S) influences ESG scores more significantly. The economic downturn could lead to a tight job market. Companies' performance in terms of employee benefits, working conditions, and labor rights will directly impact their ability to attract and retain talent.

5 Conclusion

This study delves into how companies can balance ESG investing and strategic management in the context of an economic downturn. The study found that ESG investing is essential for the long-term sustainability of companies despite heightened economic pressures. By implementing an effective ESG strategy, companies can improve their environmental and social responsibility performance. They can also strengthen their governance structures to gain a competitive advantage in the market.

First, enterprises should recognize the relationship between the direct costs of ESG investing and the long-term benefits. While there may be additional investment costs initially, these investments can deliver economic benefits in the long term through improved resource efficiency, reduced environmental fines, increased employee satisfaction and loyalty, and enhanced brand reputation.

Second, companies should seize the opportunities presented by ESG investing. For example, they can improve ESG performance to achieve lower financing costs, enhance brand value and consumer trust, and better identify and manage environmental, social and governance-related risks. At the same time, companies need to be alert to the threats of ESG investment including fierce market competition, changes in the policy environment, and the risk of "greenwashing".

During the economic downturn, companies should adopt a flexible ESG strategy. They can prioritize investments in ESG projects with high returns. They can also use cost-benefit analysis to evaluate potential ESG investments. In addition, companies should tailor ESG practices based on their industry characteristics, scale, region, and business nature.

Overall, this study highlights that companies can not only address current economic challenges by balancing ESG strategies during economic downturns, but also lay a solid foundation for sustainable development in the future. Through flexible and strategic ESG investments, companies can remain competitive in a complex market environment and achieve long-term corporate value growth.

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