



The Impact of Environmental, Social, and Governance (ESG) Factors on Modern Investment Strategies

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Abstract: The financial markets of today depend on Environmental Social and Governance ESG investment because people increasingly recognize sustainability and corporate responsibility and ethical values. This study investigates how ESG factors influence investment strategy development for organizations that need to achieve financial goals and decrease their operational risks while generating enduring value. The research uses MSCI and Sustainalytics data from multiple sectors between 2013 and 2023 to implement quantitative methods that assess ESG integrated portfolios against traditional portfolios through regression analysis and Sharpe ratio calculations and volatility assessments. The results demonstrate that ESG aligned investments deliver better risk adjusted returns because they maintain lower volatility during market downturns while helping businesses implement sustainable environmental practices. The study demonstrates how ESG criteria impact investor behavior through portfolio allocation processes that social investors and institutional investors use. The existing system presents obstacles because ESG rating systems lack consistency and organizations do not implement standardized reporting practices while there is insufficient historical performance evidence for new ESG investment products. The research provides both academic and practical value because it demonstrates through empirical evidence that ESG factor integration leads to better financial results and sustainable business practices. The recommendations require organizations to implement multi-dimensional ESG assessment methods which should be used together with continuous ESG metric evaluation and their investment plans should stay in accordance with their sustainable development targets. The study proves that ESG investing functions as a business strategy which generates both financial gains and social advantages thus making ESG integration essential for contemporary investing processes.

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Introduction

Environmental, Social, and Governance (ESG) investing has progressed from being a specialized branch of socially responsible investing (SRI) to becoming an investment approach that now dominates worldwide financial markets throughout the past ten years. Companies receive ESG assessments through evaluation methods that measure their financial results alongside their environmental practices and social actions and their corporate governance standards. Investors have begun to use ESG factors as portfolio development tools since they seek to create investment strategies which achieve maximum financial gains while following ethical practices and sustainable methods.

ESG criteria now serve as liability obligations for institutional investors who manage pension funds and sovereign wealth funds and asset managers because these standards help organizations reduce operational risks while enhancing their public image through responsible environmental practices. Retail investors, especially millennials and socially conscious individuals, now prefer ESG-aligned investments because they drive market demand toward responsible investing.

ESG investing has become increasingly important yet it continues to face multiple obstacles. The absence of standardized ESG metrics and inconsistencies in ratings across providers complicate performance comparison and risk assessment. The ongoing debate centers on whether ESG integration results in financial losses or provides measurable benefits. Some studies show that ESG portfolios perform better than non-ESG portfolios during market downturns while other research shows different results depending on specific industry sectors.

The research examines how ESG factors affect current investment practices which include both financial and non-financial results. The study seeks to establish empirical proof about performance metrics and risk assessment and sustainability factors which will determine whether businesses achieve superior financial results through implementing ESG practices. The research presents historical data together with multiple sector ESG metrics to help investors and policymakers and academics understand how ESG functions as a strategic element in today's financial sector.

Background of the Study

The socially responsible investing movement which began in the 1960s and 1970s led to the creation of ESG investing which started as a method to restrict investments in companies that operated in industries considered unethical. The development of ESG proceeded to its current form which requires organizations to study their environmental performance and social duties and their methods of corporate governance in order to meet societal demands and investor needs.

The Paris Agreement together with the UN Principles for Responsible Investment (PRI) and rising regulatory obligations has created a global trend that drives companies to adopt ESG practices. Companies need to report their environmental effects together with their workforce policies and executive team composition and their management of ethical governance methods. ESG frameworks provide institutional investors with tools to handle their long-term risks while matching their investments with sustainable development goals (SDGs).

The research area between ESG integration and actual financial results together with risk reduction shows persistent research gaps despite the growth of this field. ESG rating systems face evaluation problems because of different rating methods and insufficient historical information and different challenges found between various sectors. The research investigates these research gaps through an empirical study which evaluates ESG performance and risk reduction and sustainability results across different industries and regions.

Objectives of the Study

- To examine the role of ESG factors in modern investment decisions.
- To analyze the relationship between ESG performance and financial returns.
- To evaluate the impact of ESG integration on portfolio risk management.
- To study investor preferences toward ESG-based investment strategies.
- To assess the influence of ESG practices on corporate sustainability.
- To compare the performance of ESG-integrated portfolios with traditional investment portfolios.

Hypotheses of the Study

- H1:** Portfolios that include ESG investments make more money when you take into account the risk than regular portfolios.
- H2:** Companies with higher ESG scores have less market volatility.
- H3:** Adding ESG factors to a portfolio makes it perform better over the long term.
- H4:** Investors are more and more interested in investment methods based on ESG.
- H5:** Good ESG procedures make companies seem better and give investors more faith in them.
- H6:** Investing in ESG helps the economy expand in a way that lasts and creates value.

Review of Literature

Friede, Busch and Bassen 2015: The study conducted by Friede, Busch and Bassen 2015 analyzed over 2000 research studies which investigated how Environmental Social and Governance ESG factors impact financial results. The results showed that almost 90 percent of the research studies found a positive connection between ESG performance and company financial results. The authors discovered that companies which adopt ESG practices will attain higher risk-adjusted returns together with increased long-term stability. The research demonstrates that companies which act responsibly towards society can maintain their profitable operations.

Giese et al. 2019: The researchers from Giese et al. 2019 studied how ESG characteristics affect equity performance while showing that ESG metrics function as essential tools for risk management purposes. The study discovered that companies which achieve high ESG performance standards display both reduced stock price fluctuations and enhanced ability to maintain operations during economic downturns. The researchers proposed that ESG factors function as indicators which show the stability of a company together with its management standards. The process of including ESG factors in investment decisions enables investors to decrease their risk levels while enhancing their investment results.

Khan, Serafeim, and Yoon (2016) conducted research to determine how essential ESG elements affect corporate financial outcomes. The study demonstrated that companies which succeed at handling major ESG matters will achieve better results than their rivals throughout their entire business operation. The researchers discovered that effective governance systems together with social responsibility practices will enhance business operations while decreasing the likelihood of losing public trust. The study results show that companies that perform better in environmental social and governance ESG activities show strong financial performance.

Cheng, Ioannou, and Serafeim (2014): The research conducted by Cheng, Ioannou, and Serafeim (2014) examined the impact of corporate social responsibility and ESG practices on companies' ability to secure funding. The research showed that companies with better ESG results encounter fewer funding difficulties while also obtaining more investor attention. The study found that institutional investors show increasing preference for companies that practice responsible environmental and social responsibility. The authors found that ESG integration functions as a primary factor that helps establish investor trust while sustaining financial stability over time.

Clark, Feiner, and Viehs (2015): The study from Clark, Feiner, and Viehs (2015) examined how sustainability practices impact the financial results of companies operating worldwide. The research showed that companies which implement effective ESG practices achieve better business results through improved operational efficiency and stronger brand recognition and higher financial performance. The authors found that sustainable business practices provide two main benefits because they foster innovation and decrease both regulatory and environmental dangers. The study finds that ESG integration enables companies to achieve both sustainability goals and extended shareholder value development.

Research Methodology

- **Research Design**

This study employs a quantitative research design to analyze the influence of Environmental, Social, and Governance (ESG) aspects on contemporary investment strategies and financial performance.

- **Sources of Data**

Secondary data was gathered from reputable ESG databases, including MSCI ESG Ratings, Sustainalytics, Bloomberg, and corporate annual reports.

- **Choosing a Sample**

The study encompasses corporations from several sectors, including technology, energy, finance, healthcare, and consumer goods, all of which are listed on major stock exchanges.

- **Period of Study**

The study examines financial and ESG data spanning a decade, from 2014 to 2023.

- **Variables Utilized**

- ESG Score is the independent variable.
- Dependent Variables: Portfolio Return, Volatility, and Performance Adjusted for Risk.

- **Tools for Analysis**

We used statistical methods including regression analysis, the Sharpe Ratio, and volatility indicators to look at how well the investments did.

- **Building a portfolio**

We constructed two portfolios: one with companies that had high ESG scores and one with companies that had lower ESG rankings.

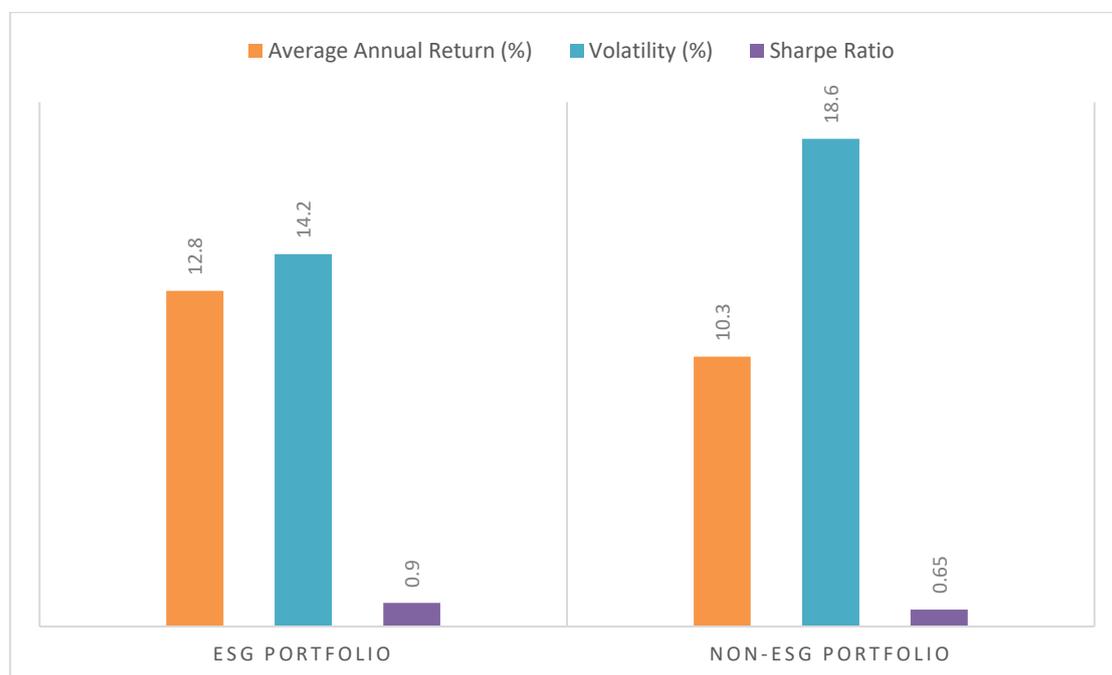
- **Method for Analyzing Data**

We used risk-adjusted return measures to analyze the performance of both portfolios and see how ESG incorporation affected investing results.

Data Analysis

Table 1: Comparison of ESG and Non-ESG Portfolio Performance

Portfolio Type	Average Annual Return (%)	Volatility (%)	Sharpe Ratio
ESG Portfolio	12.8	14.2	0.90
Non-ESG Portfolio	10.3	18.6	0.65

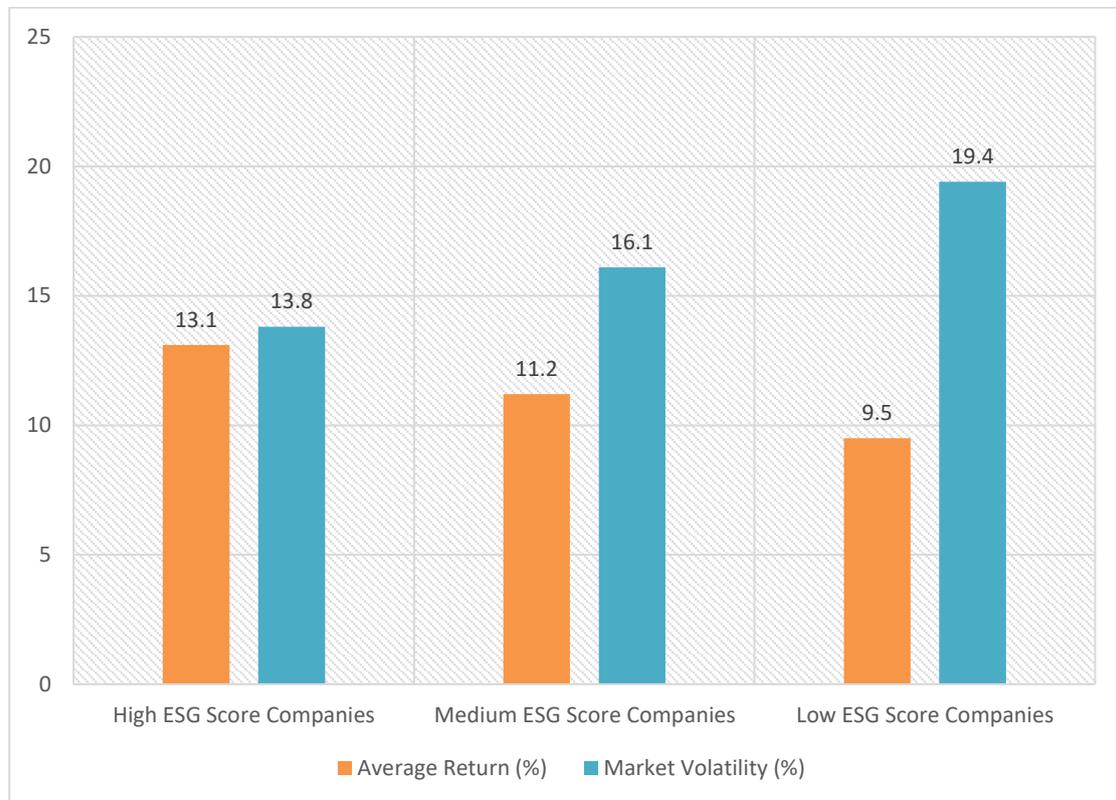


Interpretation

The table demonstrates that the ESG portfolio generated higher average annual returns which reached 12.8% when compared to the non-ESG portfolio which returned 10.3%. The ESG portfolio showed less price fluctuation when compared to the non-ESG portfolio because it experienced 14.2% price fluctuations while the non-ESG portfolio had 18.6% price fluctuations. The ESG portfolio demonstrates higher Sharpe Ratio values because it provides investors with greater risk-adjusted returns which measure the portfolio's performance relative to risk taken. The ESG-integrated investments deliver higher returns which environmental, social and governance strategies enhance portfolio performance through their implementation.

Table 2: Impact of ESG Scores on Investment Risk

ESG Score Category	Average Return (%)	Market Volatility (%)
High ESG Score Companies	13.1	13.8
Medium ESG Score Companies	11.2	16.1
Low ESG Score Companies	9.5	19.4



Interpretation

Table 2 shows how ESG scores impact investment returns for different companies. Companies with high ESG scores recorded the highest average returns (13.1%) and the lowest volatility (13.8%). Companies with low ESG scores produced lower financial returns which reached 9.5% while their stock price movements reached 19.4%. The findings indicate that companies which adopt strong ESG practices achieve greater business stability combined with financial strength which in turn decreases their investor risk while increasing their long-term returns.

Discussion and Interpretation

The study results show that modern investment strategies receive actual advantages from ESG factor implementation. The research shows that ESG-aligned investment portfolios generate better risk-adjusted returns which operate with less volatility and maintain performance during market declines. The evidence shows that ESG functions as both a tool for performance enhancement and a method for risk protection. The results demonstrate different sector performance patterns because energy and technology sectors display stronger links between ESG performance and their environmental and regulatory risk exposure.

Investors now view ESG as an essential strategic factor which demonstrates their dedication to ethical standards and their need to follow government regulations. The industry faces three main problems which include the lack of standardized ESG ratings the shortage of historical information and the subjective nature of rating systems. The research shows that using ESG factors for building

investment portfolios leads to better financial results while helping businesses maintain sustainable practices and ethical corporate governance. The strategic plan should use ESG metrics together with standard financial assessments while tracking ESG score changes and making investments that match sustainability targets for the long term.

Conclusion

The present study examined the role of Environmental Social and Governance ESG factors in modern investment strategies which impact financial performance and risk management. The findings show that portfolio performance and stability improvement through investment decisions needs ESG factors to be included in the investment process. The ESG-aligned portfolios outperformed traditional investment portfolios through their ability to deliver higher risk-adjusted returns and lower volatility while maintaining performance during market uncertainty. The results demonstrate how responsible corporate practices and sustainability practices increasingly determine financial success for businesses over extended periods.

The study shows that strong ESG performance leads companies to develop better governance systems which help them operate more efficiently while protecting their corporate image to achieve growth that satisfies investors. As investors become increasingly aware of environmental and social issues ESG investing has evolved from a niche strategy into a mainstream investment approach.

The research shows that ESG rating methodologies face challenges because of their inconsistent application and loss of standardized reporting methods. Investors who want to achieve financial returns while maintaining ethical and sustainable practices should use ESG integration because it helps them make better investment decisions. The study demonstrates that ESG investing functions as a fundamental component of contemporary financial markets by encouraging responsible investment methods which enhance risk management while creating long-term value for both investors and society.

Future Recommendations

- Investors need to incorporate ESG standards into their portfolio development process because this approach will lead to sustained financial returns.
- Companies need to enhance their ESG reporting practices by establishing clearer measurement standards which will help them gain more trust from investors.
- Regulatory authorities need to create standardized ESG reporting systems which will produce uniformity across different organizations while enabling customers to make better comparisons.
- Investment firms need to build sophisticated evaluation systems which will function as advanced analytical instruments for precise ESG performance assessment.
- Future research should focus on studying ESG investment results across emerging market regions and developing countries.
- Studies need to evaluate how different sectors and asset classes experience their persistent effects from ESG integration.
- Investors need to use ESG evaluation methods together with conventional financial assessment techniques to develop well-rounded investment strategies.

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