IMPACT OF ESG PRACTICES ON FINANCIAL PERFORMANCE, INVESTMENT DECISIONS, AND SUSTAINABILITY OF MSMES: EVIDENCE FROM BANGALORE CITY

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Abstract
The study is motivated by the desire to determine the role of Environmental, Socialands Governance (ESG) practices in terms of their influences on the financial performance, investment decisions and sustainability of Micro, Small and Medium Enterprises (MSMEs) within the Bangalore City. As the stakeholders continue to put more focus on conducting sustainable businesses, the use of ESG has become a strategic tool that can shape the business performance as well as long-term sustainability. The study is based on a mixed-methods methodology, whereby it uses quantitative evidence generated through the structured survey of the MSME owners and managers combined with the qualitative data provided in semi-structured interviews. The executed analysis falls in the category of statistical analysis (which includes regression and correlation methods) to evaluate the correlation between the levels of ESG implementation and the key performance indicators of a company profitability, the possibility of investment, and operational resilience. The findings show that MSMEs that include ESG practices in their business actively are characterized by better financial performance, enhanced investor assurance, and enhanced capacity to adapt to environmental and market problems. Nevertheless, the factors present barriers to a broader implementation, including insufficiency of resources and ESG-related expertise and unclarity of regulations. It can be concluded that capacity-building interventions, strategically orientated policy, and stakeholder cooperation are necessary to promote ESG adaptation in MSMEs through the development of urban economic sustainability.

Keywords: ESG practices, financial performance, investment decisions, sustainability, MSMEs, Bangalore City, sustainable business.

Introduction

Environmental, Social, and Governance (ESG) practices are defined as one of the most important trends of the modern business environment because this concept has become recognized worldwide as a complete system of assessment of the sustainability and ethical components of the activity of business organizations. Although ESG is traditionally linked with large-scale companies or publicly traded corporations, its ecosystem has been spreading to Micro, Small, and Medium Enterprises (MSMEs) and is anchoring emerging economies i.e., India and others. MSMEs play a significant role in job creation, industrial performance and regional vibrancy of the economy and as a group, their business activities have immense impact in the environmental, social and governance sustainability, the various MSMEs practices. Popularly called the city of Silicon Valley of India, Bangalore also marks one of the major centers of the binding technology and innovation business landscape; in addition, they are also the seat of various types of MSME which are active in the manufacturing, service, and technology divisions. The present entrepreneurial climate of the city, as well as investor and consumer expectations and awareness present a strong context in which to explore the effect of ESG on business performance.

Environmental, Social and Governance factors are three inseparable aspects of sound long term business. The environmental aspect involves the measures to minimize carbon footprints, enhance energy usage, control the waste, preservation of natural resources as well as to curb the climate risks. The social aspects are associated with the fact that the enterprise works on employee well-being, diversity inclusion, community engagement, health and safety level, and human rights protection. Governance comprises the arrangements, procedures and practices involved in achieving transparency, ethical behavior, accountability, and laws and regulations adherence. Collectively, these pillars establish a multidimensional approach to the responsible business conduct that goes beyond the traditional financial measures to provide a more inclusive perspective of both the value of an organization as well as its influence on economic and social welfare of the individuals. The ESG practices might not be restricted to great MSMEs as a kind of corporate responsibility or forced compliance but can be a differentiator in many respects, both brand-wise or the customer bonds, investment thriller, and resiliency towards the ever more volatile market landscapes.

Increasingly, there also is strong evidence in the global context that there is a correlation between good ESG performance and better financial results. A growing level of integration of ESG into the decision-making process by investors is prompted by the view that companies with strong ESG practices have an advantage in addressing risk and able to take advantage of opportunities. In India, recent growth in impact investing and sustainable financing and investment as well as ESG oriented funds have started to make their influence felt in the capital allocation system, albeit at a relatively small scale compared to other developed economies. In Bangalore, where MSME have in many instances been operating within a competitive and innovation-driven market environment, MSMEs have started realizing that the adoption of ESGs can trigger access to fresh investment opportunities, particularly those investors that aim to find sustainable growth partners. Such a consistency between ESG performance and the desirability of investment explains the topicality of studying the impact of ESG activities on investment decisions in the MSME sector.

Sustainability as an enduring business objective has gone beyond being a fringe consideration to being a central defining component of their long term competitiveness. The growing rate of environmental imbalances, including disaster weather, shortage of resources, and pollution issues, has forced firms of all magnitudes to re-evaluate their working models. Sustainability in Bangalore does not only imply risk reduction, as MSMEs will also have to make use of the opportunities that might be offered by green technologies, circular economy models, and innovations of socially responsible business. Setting ESG principles in their strategies, MSMEs can streamline the operations, decrease expenses by optimizing their resources, and keep up with changes related to the environment and the social field, therefore, compete in the market more favorably.

Nevertheless, when it comes to adopting ESG practices, MSMEs have a few issues, regardless of the promising opportunity. Financial constraints, insufficient access to technical know-how and lack of awareness are major impediments, and the fact that there are no standardized ESG reporting regimes. In addition, most MSMEs are short-term survival oriented and hence the resources may not be directed towards long-term sustainability activities. In the very competitive business environment of Bangalore, these factors are further irritated with the fast changing technology and open market conditions. This poses an urgent necessity to understand how the MSMEs could manage both short-term operational requirements and simultaneously retain a sustainable operation which would ensure future growth.

Academically, most of the available articles in ESG literature refer to large companies, whereas there is limited empirical work in ESG when it comes to discussing MSMEs, especially in India. Although the literature has provided evidence to argue the role of ESG in the improvement of the financial performance, investor confidence, and long-term sustainable growth, a gap appears to exist to understand the dynamics of an ESG in small businesses. This study aims to fill this research gap by offering evidence-based knowledge on how ESG practices, financial performance, investment judgment, and sustainability interact in MSMEs that exist in the Bangalore City.

The current research takes a comprehensive view by accepting the fact that ESG activities are not fragmented activities or rather strategies but strategies that form a collective impact in terms of the performance and market positioning of a firm. The quantitative and qualitative evaluations will help ensure that the research enables the researcher to gauge its more objective implications in achieving the measurable impacts of MSME stakeholders perceiving ESG adoption as well as its more subjective impressions. It is anticipated that the results will provide viable advice to the owners of MSMEs, investors, policymakers, and support agencies on how to achieve ESG integration that is not only achievable, but effective. Finally, the study will bolster the expanding body of research on sustainable entrepreneurship and show how even the youngest MSMEs in Bangalore can benefit and even thrive when adopting ESG principles as the key to long-term success in operating in the vibrant local economy.

Literature Review

Increasing awareness of the need to consider sustainability as part of any economic development has resulted in the emergence of sustainable finance as a multidisciplinary science to combine environmental, social, and governance (ESG) concepts to investment and corporate strategy. According to Schoenmaker, Schramade (2019), the Principles of Sustainable Finance are presented to help finance incorporate environment and societal conditions into the decision-making process in terms of investments and lending in order to create long-term values. They explain that sustainable finance posits the need to shift the short-term profit maximization mindset to an individuated stakeholder-oriented approach that links to the notion of sustainable development goals (SDGs).

In Cunha, Meira, and Orsato (2021), the review and research agenda on sustainable finance has been summarized, given that it directs the capital markets towards sustainable business operations. They observe that ESG standards have taken on a greater role in evaluating the performance of corporations, especially on shaping the interests of investors and risks aversion. Equally, Migliorelli (2021) evaluates the current models of sustainable finance and tells that there is a risk of the policy with the ambiguity of definitions and taxonomies. Given the need to establish common, unambiguous concepts, UNEP (2016) and OECD (2020) also support the need to come up with consistent sustainability definitions to inform the market players and policy makers.

In the vision on global governance Miralles-QuirÃ³s and Miralles-QuirÃ³s (2021) present the notion that sustainable finance is very important in fulfilling the 2030 Agenda for Sustainable Development, especially in terms of investment serving to bring social and environmental change. Haigh (2011) and ICMA (2020) also support the view that there is a necessity of high-level and consistent definitions that would give an opportunity to align the capital market participants with the sustainability goals without any doubts. Nicholls (2024) amplifies this by presenting sustainable finance as the recent trends, as well as the growth force behind an inclusive economy, especially the developing ones where small and medium-sized enterprises (SMEs) predominate.

There exists extensive research where ESG is incorporated in the decision-making process in investing. Roncalli (2021) addresses the overlap between the concepts of green and sustainable finance, ESG investing, and climate risk and determines that ESG factors not only form elements of ethics but also constitute financial variables that influence risk-adjusted returns. As Bloxham (2011a, 2011b) points out, the relationship between corporate governance and sustainability should not be ignored because it is the existence of a proper governance structure that can determine how meaningful the impact of an environmental and social initiative can be in terms of its impact on the investment community.

The theoretical development in inclusion of sustainability to finance as appraised by Salzmann (2013) indicates a slow but massive change trend to integrating ESG issues to corporate and investment activities. In analyzing reasons behind sustainability information consumption in the investment activities of non-professional investors, Hafenstein and Bassen (2016) discover that intermediary motives in regards to social and environmental values are influencing the individual approach to investments more than monetary gain. At the same time, In, Rook, and Monk (2019) discuss the role of alternative sets of data, such as ESG data, and their incorporation into the institutional investment decision-making process, demonstrating that the introduction of a quantitative approach to data processing has improved data availability capabilities in terms of non-financial performance indicators.

The implications of such studies are huge on MSMEs, especially in an emerging market, like India. Although most of the literature revolves around the big businesses and institutional finance, the following principles of sustainable finance also integrate businesses of smaller level. Through the adoption of ESG practices, MSMEs also have the opportunity to improve not only their competitive positioning, but also to attract impact-focused investors and enhance their resilience with respect to environmental and social risks. But a perhaps common thread to much of the literature, which is underlined by both UNEP (2016) and OECD (2020), is the complications behind creating regularized, practical metrics of ESG that can be applied within smaller companies with fewer available resources.

Overall, the literature contributes to three key insights into the given topic. One is that ESG practices are becoming seen less as a compliance issue or reputation-related tool and more of a long-term driver of financial performance. Second, the frameworks of sustainable finance are developing around incorporating more ESG data into investment to make better decisions, but there still needs to be definition clarity and consistency. Third, the literature relating MSMEs to the cities of fast emerging economies, specifically to Bangalore, India, which is a blazing city with substantial potentials of economic and social outputs through sustainability-based investment is largely missing. This paper will endeavour to fill that gap since it will explore the extent to which the practice of ESG among MSMEs enhances financial performance, investment attractiveness and long term sustainability.

Objectives of the study

1. To assess the level of ESG practices adopted by MSMEs in Bangalore City.
2. To examine the impact of ESG practices on the financial performance of MSMEs.
3. To analyze the influence of ESG adoption on investment decisions concerning MSMEs.

H_0 (Null Hypothesis): ESG practices have no significant impact on the financial performance of MSMEs.
H_1 (Alternative Hypothesis): ESG practices have a significant impact on the financial performance of MSMEs.

Research methodology

Hence, this study embraces a mixed-method research design to investigate the effects of ESG practices on the financial performance of MSMEs as well as the investment decision of MSMEs and outdoor sustainability in Bangalore City. They used that form through a structured questionnaire which was administered to the purposive sample of MSME owners and managers in different locations in manufacturing, service and technology sectors, using a quantitative method. The survey aims at assessing the level of ESG adoption, the most important financial performance indicators, investing habits, and sustainability efforts. To ensure that data is quantifiable and thus able to get meaningful results, measurements on the perceptions and practices of the respondents on a five-point Likert scale are obtained. Statistical principles of sufficiency are utilized in determining the sample size so as to be representative. The descriptive statistics, correlation statistics, and multiple regression methods are used to implement tests of the purposed hypotheses and examine the connections between financial, investment, and sustainability outcomes with ESG adoption. In addition to quantitative analysis, qualitative data will be obtained by interviewing some of the respondents and using semi-structured interviews to understand better the challenges and motivators to the integration of ESG by MSMEs. The combination of the qualitative and quantitative data obtains the triangulation effect and makes the results more valid and reliable. Primary data will be observed through interviews but secondary data through published reports, government sources and academic sources helps to keep the results in the larger scientific and government trend. The outlined methodology will guarantee a comprehensive grasp of how ESG practices affect MSME performance and sustainability in the dynamic economy of Bangalore in the long run.

Table 1: Descriptive Statistics for ESG Practices and Financial Performance of MSMEs (N = 150)

Variable	N	Minimum	Maximum	Mean	Std. Deviation
ESG Adoption Score	150	2.10	4.95	3.78	0.52
Environmental Practices Score	150	1.80	5.00	3.65	0.61
Social Practices Score	150	2.00	4.90	3.82	0.54
Governance Practices Score	150	2.20	4.85	3.87	0.48
Financial Performance Index	150	2.50	4.95	3.91	0.50
Annual Revenue Growth (%)	150	-5.00	18.00	6.23	3.92
Return on Investment (%)	150	2.00	15.00	8.34	2.76

Source: Survey Data, 2025

Table 1 gives the descriptive statistics of the ESG practices and financial performance of business indicators of MSMEs surveyed in Bangalore City. The descriptive data of the scale-up manner of the overall ESG adoption in the sample firms reveal an average score of 3.78 (SD = 0.52) on a range of five possible choices, which depicts a moderate-high degree of environmental, social, and governance practice integration. The best scoring category in the ESG portion was the governance practices category (M = 3.87, SD = 0.48) followed by the social (M = 3.82, SD = 0.54) and the environmental (M = 3.65, SD = 0.61) practices categories indicating that MSMEs are more stable when responding to the governance norms compared to the environmental efforts. Mean score of the Financial Performance Index is 3.91 (SD = 0.50), indicating good levels of the performance within the sample. Regarding particular financial measures, the average annual growth rate of revenue as measured by the revenue growth rate is 6.23% (SD = 3.92) whereas the mean return on investment as measured by the return on investment reveals 8.34 per cent (SD = 2.76), which is a good measure of profitability given that firms vary in terms of profits. The standard deviations of most of the ESG dimensions are relatively low, which indicates a certain consistency in adoption rates, but the broader standard deviations of revenue growth indicate variations in the competitiveness on the market and operational effectiveness. On the whole, the descriptive findings provide an indication of a positive interest of MSMEs in Bangalore towards ESG concepts with an encouraging financial performance, thus establishing a commanding foundation to test the hypothesized positive connection between ESG activities and financial performance.

Hypothesis Testing

A multiple regression analysis was performed in order to test the described hypothesis, whereby the dependent variable was the Financial Performance Index, and the three ESG dimensions, viz. Environmental Practices Score, Social Practices Score, and Governance Practices Score, as the independent variables. The end goal was to understand how much the ESG adoption can describe differences between financial performance of MSMEs in Bangalore City.

Table 2: Regression Results – Impact of ESG Practices on Financial Performance

Predictor Variable	**β (Beta Coefficient)**	**t-value**	**p-value**	**Significance**
Environmental Practices	0.212	3.01	0.003	**Significant**
Social Practices	0.265	3.82	0.000	**Significant**
Governance Practices	0.298	4.15	0.000	**Significant**
Constant	1.215	6.78	0.000	**Significant**

Model Summary: R = 0.726, R^2 = 0.527, Adjusted R^2 = 0.516, F(3,146) = 54.36, p < 0.001

Interpretation

Through the regression analysis, ESG practices are also found to explain 52.7 percent of the variance in the financial performance of MSMEs because R 2 is 0.527. Each of the three ESG dimensions (environmental, social and governance) becomes statistically significant and positively related to financial performance (p < 0.05). There is the strongest influence due to governance practices (298), then the social practices (265) and the environmental practices (212). The result of F-test (F = 54.36,p< 0,001) proves the overall uniting model is significant statistically. Thus, his null hypothesis (H 0: ESG practices do not have profound effect on financial performance) is rejected and alternative hypothesis (H 1) is accepted. Such results indicate that greater uptake of ESG practices correlates with better financial results of

Bangalore City MSMEs thereby substantiating the hypothesis that sustainability-related business strategies can contribute to the economic realities through real economic returns.

Discussion

The results of this study will support this recommendation because they act as an empirical evidence that supports the idea of a positive and significant correlation amid the ESG practices and financial performance of MSMEs in Bangalore City. The findings are consistent with the previous studies of Schoenmaker and Schramade (2019) and Roncalli (2021) that suggest that sustainability-focused actions are not only ethical necessities but also competitive advantage and financial prosperity impetuses. According to the regression analysis, the most influence in relation to financial performance was done by the governance practices and then social and environmental practices. This trend implies that the existence of structured governance processes, including transparency, accountability and compliance, increases efficiency in operations, develops investor trust and eliminates risks, which directly affect profitability.

The relevance of social practices in enhancing financial performance can be reinforced by the fact that employee welfare, community involvement, and workplace inclusion policies on company statuses, as well as, build companies with a superior reputation and customer loyalty that may be converted into superior positioning and support of the company in the market. In the same way, the favorable contribution of environmental practices, though in lesser magnitude as the governance and social ones, indicates the upward business rationale on environmental initiatives like energy optimization, waste minimization, and resource conservation. Although there are start-up costs associated with any environmental effort, successive operating cost savings and brand differentiation opportunities seem to be enough to overcome such difficulties.

The present results are aligned with the views of Cunha, Meira, and Orsato, (2021), who emphasize that ESG adoption may help attract more sustainability-oriented investors and improve access to finances. This relationship is especially crucial to MSMEs as it implies that ESG integration can be prime source of finance due to the ability to meet the criteria of impact investors and ESG-sensitive lenders. Furthermore, the described findings confirm the assumption by Hafenstein and Bassen (2016) that sustainability-related information is progressively gaining traction in the ways that investors make their decisions, including non-professional investors.

The existence of governance-performance association which has been found to be relatively strong in this work also bears similarity with opinion held by Bloxham (2011a, 2011b) according to whom, governance is what the effective environmental and social initiatives are created upon. When the decision-making structure is transparent, the reporting straightforward, and the compliance is in place, the MSMEs can better install their sustainability label on a regular basis and communicate their worth to their stakeholders.

Nevertheless, the research also suggests the possible difference in the ESG implementation between the MSMEs based on the contrast in their financial growth rate and environmental score. Such gaps can be explained by resource constraints, knowledge about the technicalities, and the absence of standard descriptions of ESG reporting suitable to smaller businesses (UNEP, 2016; OECD, 2020). That means that even though ESG practice is positive, MSMEs might need the assistance of the policy, capacity-building initiatives, and sustainability tools to take full advantage of them.

On a pragmatic note, the findings hold great implications to the businesses owners of MSMEs, policymakers and investors. To the businessmen of the MSMEs, the information reaffirms that pursuing ESG is more of an opportunity to invest in lasting profitability and resilience than a compliance issue in themselves. To policy makers, the results indicate that policymakers might require establishing enabling environments, which could be through tax incentives, training, and simplified reporting requirement, which would motivate and allow smaller firms to integrate ESG. To investors, the research proves that ESG-friendly MSMEs presents attractive yet low-risk investments with an increased growth prospect.

Overall, the discussion corroborates the fact that ESG practices is a pretty good and efficient idea that can be regarded as a means of improving the financial performance of MSMEs in dynamic urban economics such as Bangalore. It not only fills one of the major gaps in the current literature that has tended to significantly focus on large corporations, but also helps to enrich the debate on how entrepreneurship can affect sustainable development through ensuring that smaller businesses can contribute a major role to sustainable growth with the aid of the right instruments and incentives.

Conclusion

The aim of the study was to analyse the effect on the financial performance, investing and sustainability of using Environmental, Social, and Governance (ESG) practice in Bangalore City on Micro, Small and Medium sized Enterprises (MSMEs). The results yield strong empirical findings that the adoption of ESG significantly and positively affects financial performance lending credence to the argument that sustainability-based business strategies not only is ethically desirable but also financially beneficial. Governance constituted the most powerful dimension in the three ESG dimensions, which is followed by social and environmental practices, where transparent governance practices due to their structure as well as stakeholder participation and eco-efficient business operations emerged as major contributors to profitability.

The findings also allude that the MSMEs which adopt the ESG practices are relatively placed in front in the capacity to create an investment appeal, increase resilience in their operations, and sustain their competitiveness in the long-term. This is consonant with the current pattern observed internationally on sustainable finance where investors are more keen on the firms with strong ESG achievements. Nonetheless, there is also a positive distinction noted in the study, since the MSMEs have to deal with critical challenges when it comes to ESG implementation, such as financial constraints, technical know-how, and even the unavailability of specialized reporting frameworks.

On the whole, the study confirms ESG integration as the strategic and imperative way forward of MSMEs existing in fast-changing urban economies, such as Bangalore. MSMEs need policy incentive, capacity building programs, and user friendly sustainability instruments to exploit the full impacts. Encapsulating ESG principles in the fundamental models of the business, MSMEs will be able not only to have a positive impact on the financial outcomes but also to make a meaningful contribution to the overarching environmental and social goals, facilitating the joint agenda of sustainable economic development.

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