

IMPACT OF ESG PRACTICES ON FINANCIAL PERFORMANCE, INVESTMENT DECISIONS AND SUSTAINABILITY OF MSMEs: EVIDENCE FROM CUTTACK CITY, ODISHA

Lt. (Dr.) Prabir Kumar Mohapatra¹

Mr. Gobinda Chandra Malik²

¹ Lecturer in Commerce, Charampa Mahavidyalaya, Charampa, Bhadrak. Email Id: prabir1988@gmail.com

² Lecturer in Commerce, Charampa Mahavidyalaya, Charampa, Bhadrak Email Id: gmalik.odisha@gmail.com

Abstract:

The goal of the study is to ascertain how Environmental, Social, and Governance (ESG) practices affect the financial performance, investment choices, and sustainability of MSMEs in Cuttack City. ESG has emerged as a strategic tool that may influence both long-term sustainability and company success as stakeholders continue to place greater emphasis on running sustainable firms. The study used a mixed-methods approach, combining qualitative information from semi-structured interviews with quantitative data from a structured survey of MSME owners and managers. In order to assess the relationship between the degrees of ESG implementation and the key performance indicators of a company's profitability, investment potential, and operational resilience, statistical analysis—which includes regression and correlation techniques—is used. The results demonstrate that MSMEs who actively incorporate ESG principles into their operations exhibit improved financial performance, increased investor certainty, and improved adaptability to market and environmental issues. However, the factors—such as a lack of resources and ESG-related skills, as well as unclear regulations—present obstacles to a wider adoption. In order to encourage ESG adaptation in MSMEs through the development of urban economic sustainability, capacity-building interventions, strategically oriented policy, and stakeholder collaboration are required.

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

Introduction

The concept of Environmental, Social, and Governance (ESG) practices has gained international recognition as a comprehensive framework for evaluating the ethical and sustainable aspects of business operations, making it one of the most significant trends in the contemporary business environment. Even though ESG is typically associated with big businesses or publicly listed organisations, its ecosystem has been expanding to Micro, Small, and Medium-Sized Enterprises (MSMEs) and is supporting emerging economies like India. MSMEs contribute significantly to industrial performance, job creation, and the vibrancy of the

¹ Lecturer in Commerce, Charampa Mahavidyalaya, Charampa, Bhadrak. Email Id: prabir1988@gmail.com Mob: 9437151202

² Lecturer in Commerce, Charampa Mahavidyalaya, Charampa, Bhadrak Email Id: gmalik.odisha@gmail.com

regional economy. Collectively, their operations have a huge influence on the sustainability of the environment, society, and government, as well as the numerous MSME practices. the technological, manufacturing, and service sectors. The city's current entrepreneurial atmosphere, along with investor and consumer expectations and knowledge, offer a compelling framework for examining how ESG affects company success. Three essential components of a successful long-term company are environmental, social, and governance considerations. The environmental component includes actions to reduce carbon footprints, improve energy use, manage waste, protect natural resources, and reduce climate threats. The company's efforts to promote employee well-being, diversity and inclusion, community involvement, health and safety, and human rights protection are all related to social issues. The structures, processes, and practices necessary to achieve accountability, ethical behavior, transparency, and rules and regulations are all part of governance. Together, these pillars create a multifaceted framework for ethical business practices that extends beyond conventional financial metrics to offer a broader view of an organization's worth and its impact on people's social and economic well-being's practices may be a differentiator in many ways, including customer bonds, investment thrillers, resilience to the ever-changing market environments, and brand-wise. They may not be limited to outstanding MSMEs as a form of corporate responsibility or mandated compliance. Strong evidence of a link between improved financial outcomes and high ESG performance is becoming more and more prevalent in the global setting. Investors' perception that businesses with robust ESG policies have an edge in managing risk and seizing opportunities is driving an increasing degree of ESG integration into the decision-making process. Though on a smaller scale than in other developed nations, impact investing, sustainable finance and investment, and ESG-oriented funds have just begun to have an impact on the capital allocation system in India. MSMEs in Cuttack, where they have frequently operated in a competitive and innovative market environment, have begun to recognise that the adoption of ESGs can open up new investment opportunities, especially for investors looking to find partners for sustainable growth. This correlation between investment attractiveness and ESG performance explains why research on how ESG practices affect investment choices in the MSME sector is so current. As an ongoing corporate goal, sustainability has evolved from a minor issue to a key factor in determining a company's long-term competitiveness. Environmental imbalances, such as weather-related disasters, resource scarcity, and pollution problems, are becoming more frequent and have compelled businesses of all sizes to reassess their operational strategies. In Cuttack, sustainability is more than just lowering risk; MSMEs will also need to take advantage of potential possibilities presented by green technology, circular economy models, and innovations from socially conscious businesses. By incorporating ESG concepts into their strategy, MSMEs may improve their competitiveness in the market by streamlining their operations, cutting costs via resource optimisation, and staying up to date with environmental and social developments. Despite the great possibility, MSMEs have several challenges when it comes to implementing ESG principles. Major obstacles include lack of knowledge, lack of access to technical know-how, and financial limitations. Additionally, there are no standardized ESG reporting regimes. Moreover, the majority of MSMEs prioritize short-term survival above long-term sustainability initiatives, which may result in a lack of funding. These challenges are made worse by the rapidly evolving technology and open market circumstances in Cuttack's

fiercely competitive business environment. Understanding how MSMEs may manage both short-term operations and concurrently maintain a sustainable operation, which would guarantee future growth, is imperative.

Academically, the majority of the ESG literature's publications cover large corporations, but there is not much empirical research on MSMEs, particularly in India. There seems to be a knowledge gap about the dynamics of ESG in small enterprises, despite the literature offering evidence to support the significance of ESG in enhancing financial performance, investor confidence, and long-term sustainable growth. This study intends to close this research gap by providing evidence-based information on the interactions between sustainability, financial performance, investment judgment, and ESG practices in MSMEs located in Cuttack City.

The present study adopts a holistic perspective by acknowledging that ESG initiatives are not discrete actions or tactics, but rather strategies that contribute to a firm's overall performance and market positioning. The researcher will be able to assess the research's more objective consequences in attaining the quantifiable impacts of MSME stakeholders perceiving ESG adoption as well as its more subjective impressions, thanks to the quantitative and qualitative assessments. The findings should give investors, legislators, MSMEs' owners, and support organisations practical guidance on how to accomplish ESG integration in a way that is both feasible and successful. Lastly, the study will contribute to the growing corpus of research on sustainable entrepreneurship by demonstrating how even Cuttack's youngest MSMEs may profit from and even prosper from using ESG principles as the secret to long-term success in functioning in the thriving local economy.

Literature Review

Sustainable finance has emerged as a multidisciplinary discipline to integrate environmental, social, and governance (ESG) ideas to investment and business strategy as a result of growing awareness of the necessity of considering sustainability as part of any economic progress. In order to generate long-term value, Schoenmaker and Schrade (2019) state that the Principles of Sustainable Finance are designed to assist the financial industry in taking social and environmental factors into account when making lending and investment decisions. They clarify that the concept of sustainable development goals (SDGs) is linked to sustainable finance, which suggests a shift from short-term profit maximisation to an individualised, stakeholder-oriented approach. The review and research agenda on sustainable finance has been summarized by Cunha, Meira, and Orsato (2021), who point out that it guides the capital markets toward sustainable corporate operations. They note that ESG norms now play a bigger part in assessing how well businesses are doing, particularly when it comes to influencing investor interests and risk aversion. Similarly, Migliorelli (2021) assesses the existing models of sustainable finance and notes that the policy's uncertainty in definitions and taxonomies poses a concern. UNEP (2016) and the OECD (2020) both endorse the need to develop standard sustainability definitions in order to inform market participants and policymakers about the need to establish clear, shared ideas.

According to Miralles-Quirós and Miralles-Quirós (2021), the idea that sustainable finance is crucial to achieving the 2030 Agenda for Sustainable Development, particularly when it comes to investments that promote social and environmental transformation, is presented in their Global Governance Vision. Haigh (2011) and ICMA (2020) both endorse the idea that high-level and uniform definitions are required in order to provide a chance to unambiguously align capital market players with sustainability goals. This is reinforced by Nicholls (2024), who highlights sustainable financing as a new trend and the driving force behind an inclusive economy, particularly in emerging nations where SMEs are the majority. The integration of ESG considerations into financial decision-making has been the subject of much study. Roncalli (2021) investigates the relationship between climate risk, green and sustainable finance, and ESG investment. He comes to the conclusion that ESG characteristics are both financial variables that affect risk-adjusted returns and components of ethics. The relationship between corporate governance and sustainability should not be disregarded, as Bloxham (2011a, 2011b) notes, because the presence of an appropriate governance structure can determine the significance of an environmental and social initiative's impact on the investment community. According to Salzmann (2013), the theoretical advancement in the integration of sustainability into finance points to a gradual but significant shift in the direction of incorporating ESG concerns into business and investment operations. Hafenstein and Bassen (2016) find that intermediary motives pertaining to social and environmental values are influencing the individual approach to investments more than monetary gain when analyzing the reasons behind sustainability information consumption in the investment activities of non-professional investors. However, Rook and Monk (2019) show that the adoption of a quantitative approach to data processing has enhanced data availability capabilities in terms of non-financial performance indicators. They also discuss the role of alternative sets of data, such as ESG data, and their incorporation into the institutional investment decision-making process. Such findings have significant ramifications for MSMEs, particularly in a developing market like India. The following sustainable finance concepts also apply to smaller enterprises, even though the majority of the literature focuses on large corporations and institutional finance. In addition to improving their competitive advantage, MSMEs may also draw in impact-focused investors and strengthen their resilience to social and environmental hazards by implementing ESG practices. However, a recurring theme in much of the literature—highlighted by both UNEP (2016) and OECD (2020)—is the difficulty of developing regularised, useful ESG indicators that may be used in smaller businesses with fewer resources.

Overall, the literature offers three important perspectives on the subject at hand. One is that ESG practices are increasingly viewed as a long-term driver of financial performance rather than a tool for compliance or reputation. Second, although there is still a need for a more precise definition and more uniformity, the frameworks of sustainable finance are evolving to include more ESG data in investment decision-making. Third, there is a dearth of research on MSMEs in fast-emerging economies, particularly Cuttack, India, a vibrant city with significant potential for social and economic benefits from sustainability-based investment. By investigating the degree to which ESG practices among MSMEs improve financial performance, investor attractiveness, and long-term sustainability, this article will attempt to close that gap.

Objectives of the study

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

Hypothesis of the Study

H₀ (Null Hypothesis): ESG practices have no significant impact on the financial performance of MSMEs in Cuttack City.

H₁ (Alternative Hypothesis): ESG practices have a significant impact on the financial performance of MSMEs in Cuttack City.

Research methodology

As a result, this study uses a mixed-method research approach to examine how ESG practices affect MSMEs' financial performance, investment choices, and outdoor sustainability in Cuttack City. They employed that form in a quantitative manner by distributing a structured questionnaire to a purposive sample of MSME owners and managers in various locations in the manufacturing, service, and technology sectors. The purpose of the study is to evaluate investment practices, sustainability initiatives, the most significant financial performance metrics, and the degree of ESG adoption.

To ensure that data are quantifiable and yield meaningful results, measurements of respondents' perceptions and practices are obtained on a five-point Likert scale. Statistical principles of sufficiency are utilised to determine the sample size to ensure representativeness. The descriptive statistics, correlation statistics, and multiple regression methods are used to implement tests of the proposed hypotheses and examine the connections between financial, investment, and sustainability outcomes with ESG adoption. To further understand the obstacles and drivers of MSMEs' integration of ESG, semi-structured interviews with some of the respondents will be used to collect qualitative data in addition to quantitative research. The triangulation effect is obtained by combining the qualitative and quantitative data, which increases the validity and dependability of the findings. Interviews will be used to gather primary data, while secondary data from published publications, government agencies, and scholarly sources keeps the findings within the broader scientific and governmental trend. The described approach would ensure a thorough understanding of how ESG practices impact MSME performance and sustainability in the long-term dynamic economy of Cuttack city, particularly in Odisha state.

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 |

Table 1 presents the descriptive statistics on the ESG practices and financial performance of business indicators for MSMEs surveyed in Cuttack City. The descriptive data on the scale-up of overall ESG adoption in the sample firms reveal an average score of 3.78 (SD = 0.52) on a five-point scale, indicating a moderate-to-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 performance within the sample. In terms of specific financial metrics, the average yearly growth rate of revenue, as determined by the revenue growth rate, is 6.23% (SD = 3.92), while the mean return on investment, as determined by the return on investment, is 8.34% (SD = 2.76). This is a good indicator of profitability because different businesses have different profit margins from one another. While the greater standard deviations of revenue growth show fluctuations in market competitiveness and operational effectiveness, the standard deviations of the majority of the ESG dimensions are quite modest, indicating a certain stability in adoption rates.

On the whole, the descriptive findings provide an indication of a positive interest of MSMEs in Cuttack city towards ESG concepts with an encouraging financial performance, thus establishing a commanding foundation to test the hypothesised positive connection between ESG activities and financial performance.

Hypothesis Testing

The Financial Performance Index was used as the dependent variable and the three ESG dimensions—the Environmental Practices Score, Social Practices Score, and Governance Practices Score—as the independent variables in a multiple regression analysis to test the hypothesis. The ultimate objective was to determine the extent to which the financial performance of MSMEs in Cuttack City can be explained by the adoption of ESG.

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

Regression study reveals that ESG practices account for 52.7% of the variation in MSMEs' financial performance ($R^2 = 0.527$). Every one of the three ESG dimensions—governance, social, and environmental—becomes statistically significant and has a positive correlation with financial success ($p < 0.05$).

The practices of governance have the greatest impact (298), followed by social practices (265), and environmental practices (212). The overall unifying model is statistically supported by the F-test result ($F = 54.36$, $p < 0.001$). As a result, the alternative hypothesis (H_1) is supported, and the null hypothesis (H_0 : ESG efforts do not significantly impact financial performance) is rejected. The notion that sustainability-related business strategies may contribute to the economic reality through actual economic returns is supported by these data, which show that higher adoption of ESG practices corresponds with better financial performance of Cuttack City MSMEs.

Discussion

The study's findings will bolster this advice as they provide empirical support for the notion that there is a strong and positive relationship between MSMEs' financial success in Cuttack City and their ESG practices. The results align with earlier research by Roncalli (2021) and Schoenmaker and Schramade (2019), which indicates that sustainability-focused initiatives are not only morally required but also a competitive advantage and drivers of financial growth. Regression analysis revealed that governance practices had the greatest impact on financial success, followed by social and environmental activities.

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 impact of workplace inclusion, community service, and employee welfare policies on business standing, as well as on creating companies with a strong reputation and devoted clientele, can be translated into better market positioning and support for the business, further demonstrating the importance of social practices in improving financial performance. Similarly, the positive impact of environmental practices—albeit to a smaller extent than that of governance and social practices—indicates the growing commercial case for environmental measures such as resource conservation, waste minimisation, and energy optimisation. Any environmental initiative has initial expenses, but potential for brand distinctiveness and subsequent operating cost savings appear to be sufficient to offset these challenges. The present results are aligned with the views of Cunha, Meira, and Orsato (2021), who emphasise 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 a 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 a governance-performance association, which is relatively strong in this work also bears similarity with the 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 is 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 for the business 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 itself. To policymakers, the results indicate that policymakers might require establishing enabling environments, which could be achieved through tax incentives, training, and simplified reporting requirements, which would motivate and allow smaller firms to integrate ESG. To investors, the research proves that ESG-friendly MSMEs present attractive yet low-risk investments with an increased growth prospect.

Overall, the discussion corroborates the fact that ESG practices are a pretty good and efficient idea that can be regarded as a means of improving the financial performance of MSMEs in dynamic urban economies 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 by ensuring that smaller businesses can play a major role in sustainable growth with the aid of the right instruments and incentives.

Conclusion

The study aimed to analyse the effect on the financial performance, investing and sustainability of using Environmental, Social, and Governance (ESG) practice in Cuttack City on Micro, Small and Medium-sized Enterprises (MSMEs). The results gain strong empirical findings that the adoption of ESG significantly and positively affects financial performance, lending credence to the argument that sustainability-based business strategies are not only 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.

According to the findings, MSMEs that implement ESG practices are comparatively in the forefront when it comes to their ability to attract investment, boost operational resilience, and maintain long-term competitiveness. This is consistent with the current global trend in sustainable finance, where investors are more interested in companies that have demonstrated significant ESG success. However, the study also identifies a positive distinction: MSMEs face significant obstacles in implementing ESG, including a lack of funding, technical expertise, and even specialised reporting systems.

Overall, the study confirms that ESG integration is the necessary and strategic path ahead for MSMEs operating in rapidly evolving urban economies. To fully reap the benefits, MSMEs require regulatory incentives, capacity-building initiatives, and easily navigable sustainability tools. By incorporating ESG principles into their core business models, MSMEs can contribute significantly to the overall environmental and social objectives while also improving financial results, thereby supporting the shared agenda of sustainable economic development.

References

1. Bloxham, E. (2011a). Corporate governance and sustainability: New and old models of thinking. *Journal of Sustainable Finance & Investment*, 1(1), 77–80. <https://doi.org/10.1080/20430795.2011.556805>.

2. Bloxham, E. (2011b). The knowledge gap between investors and companies. *Journal of Sustainable Finance & Investment*, 1(2), 156–158. <https://doi.org/10.1080/20430795.2011.586459> .
3. Cunha, F. A. F. d. S., Meira, E., & Orsato, R. J. (2021). Sustainable finance and investment: Review and research agenda. *Business Strategy and the Environment*, 30(8), 3821–3838. <https://doi.org/10.1002/bse.2852>
4. Haigh, M. (2011). The Journal of Sustainable Finance & Investment. *Journal of Sustainable Finance & Investment*, 1(1), 3–4. <https://doi.org/10.1080/20430795.2011.556882>
5. Hafenstein, A., & Bassen, A. (2016). Influences for using sustainability information in the investment decision-making of non-professional investors. *Journal of Sustainable Finance & Investment*, 6(3), 186–210. <https://doi.org/10.1080/20430795.2016.1201540>
6. ICMA. (2020). Sustainable finance high-level definitions. International Capital Market Association. <https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Sustainable-Finance-High-Level-Definitions-May-2020-051020.pdf>
7. In, S. Y., Rook, D., & Monk, A. (2019). Integrating alternative data (also known as ESG data) in investment decision making. *Global Economic Review*, 48(3), 237–260. <https://doi.org/10.1080/1226508X.2019.1648210>
8. Migliorelli, M. (2021). What do we mean by sustainable finance? Assessing existing frameworks and policy risks. *Sustainability*, 13(2), 975. <https://doi.org/10.3390/su13020975>
9. Miralles-Quirós, M. M., & Miralles-Quirós, J. L. (2021). Sustainable finance and the 2030 Agenda: Investing to transform the world. *Sustainability*, 13(18), 10505. <https://doi.org/10.3390/su131810505>
10. Nicholls, A. (2024). A primer and recent developments. Asian Development Bank. <https://www.adb.org/sites/default/files/institutional-document/691951/ado2021bp-sustainable-finance.pdf>
11. OECD. (2020). Developing sustainable finance definitions and taxonomies. Organisation for Economic Co-operation and Development. <https://www.oecd.org/env/developing-sustainable-finance-definitions-and-taxonomies-134a2dbe-en.htm>
12. Roncalli, T. (2021). Green and sustainable finance, ESG investing and climate risk. SSRN. <https://ssrn.com/abstract=3769378>
13. Salzmann, A. J. (2013). The integration of sustainability into the theory and practice of finance: An overview of the state of the art and outline of future developments. *Journal of Business Economics*, 83(6), 555–576. <https://doi.org/10.1007/s11573-013-0680-x>
14. Schoenmaker, D., & Schramade, W. (2019). Principles of sustainable finance. Oxford University Press. <https://ssrn.com/abstract=3282699>
15. UNEP. (2016). Definitions and concepts: Background note.
16. United Nations Environment Programme
17. https://wedocs.unep.org/bitstream/handle/20.500.11822/10603/definitions_concept.pdf