

The Impact of ESG Practices on SME Value Creation: Mediating Roles of Multidimensional Performance Metrics

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Abstract

This study investigates the relationship between Environmental, Social, and Governance (ESG) practices and value creation in Small and Medium-sized Enterprises (SMEs) with the mediating role of Multi-Dimensional Performance measures (MDP). Using a descriptive and causal research design with stratified random sampling, primary data were collected with a survey from 320 SMEs in Thiruvallur District, India. Findings reveal that ESG practices significantly impact value creation ($\beta = 0.384$) and MDP mediates this relationship ($\beta = 0.247$) indicates that ESG initiatives enhance value indirectly through improved performance metrics. The total effect of ESG on value creation is strong ($\beta = 0.643$) highlights the benefits of integrating ESG into business strategies. The findings bring out the strategic importance of prioritizing ESG initiatives to enhance performance and value creation. Managers are encouraged to prioritize ESG initiatives to align with stakeholder expectations, and invest in training and resources to build ESG capabilities, while policymakers should create a regulatory environment that rewards sustainable practices. Future research should explore the role of digital transformation and AI in ESG performance through longitudinal studies.

Keywords: Business Sustainability, Environmental, Social, Governance (ESG), Multi-Dimensional Performance (MDP), Small Medium Enterprises (SMEs), and Value Creation

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Introduction

Environmental, Social, and Governance (ESG) principles are transforming the business landscape particularly for Small and Medium-sized Enterprises (SMEs) as they respond to the global climate crisis, consumer demand, and government regulations (India Today, 2024). A study by McKinsey and NiesenIQ highlights that

companies with proven ESG claims experienced 28% growth over five years, compared to just 20% for those without, accentuate the competitive advantage of sustainable practices. Indian startups are increasingly adopting sustainability strategies to balance profit and environmental responsibility fostering long-term value creation (TICE News, 2024).

To effectively assess ESG performance, multidimensional performance measures (MDP) are essential, incorporating both financial and non-financial metrics such as operational excellence and customer satisfaction. While SMEs can achieve operational efficiency and new market opportunities through ESG adoption, still face challenges in implementation and measurement, revealing a critical research gap. This study aims to investigate the causal linkages between ESG adoption and sustainable value generation, evaluate the mediating role of MDP metrics, and design a practical framework for integrating ESG into SME performance systems. Ultimately, this research will help SMEs leverage ESG for long-term resilience and informed decision-making in the sustainability journey.

Literature Review

Theoretical Foundations

A theoretical framework provides a structured approach to understand how ESG Environmental, Social, and Governance practices contribute to value creation in SMEs. Stakeholder Theory emphasizes the importance of recognizing the needs of diverse stakeholders, such as customers, employees, and communities for long-term success (Freeman, 1984). Tapaninaho et al. (2020) and Kivleniece et al. (2021) highlights that ESG practices foster stakeholder trust, loyalty, and innovation, leading to competitive advantage. McGahan (2023) further emphasizes the balance of economic, environmental, and social responsibilities for better financial and social outcomes.

The Resource Based View (RBV) suggests that unique resources such as skilled labor and ESG-aligned assets enable SMEs to achieve a competitive edge (Barney, 1991). Nguyen (2023) and Omri et al. (2024) provide examples of SMEs

leveraging energy efficient technologies and eco-design to capture niche markets and improve performance. Performance Measurement Theory integrates financial and nonfinancial metrics for a comprehensive assessment of organizational performance (Kaplan & Norton, 1992). SME-specific frameworks, such as the Balanced Scorecard align ESG initiatives with strategic goals, boosting value creation (Ricardo Malagueno et al. 2018; Singh et al. 2016).

The Triple Bottom Line (TBL) theory aligns financial performance with societal and environmental stewardship, balances profitability and community welfare (Elkington, 1997). TBL strategies lead to sustainable innovation, economic stability, and enhanced stakeholder trust (Munoz Pascual et al. 2019; Garcia Sanchez et al. 2017). Collectively, the theories illustrate how ESG practices promote stakeholder participation, innovation, and long-term resilience in SMEs.

ESG Practices in SMEs

Despite resource constraints and limited awareness, SMEs are increasingly adopting ESG practices that yield both tangible and intangible benefits (Shalhoob & Hussainey, 2022; Singh & Pillai, 2021a). Environmental practices, such as solar panel adoption, reduce operational costs and promote sustainability, indirectly contributing to value creation (Taddeo et al. 2024). Social responsibility initiatives, including community engagement and ethical labor practices, enhance social value, improve employee retention, and strengthen reputation (Smith et al. 2022; Aminudin, 2013; Thanh Tiep Le, 2021).

Governance practices, such as compliance with corporate governance principles, reduce operational risks, attract investors, and improve financial performance (Arthur, 2016; Campbell & Minguez Vera, 2008; Singh & Pillai, 2021).

Enhanced governance also facilitates innovation and operational excellence (*Broadstock et al. 2019*). Overall, ESG practices in SMEs contribute to sustainability, reputation, and financial success

Multidimensional Performance Measures

Multidimensional performance measures integrate financial, nonfinancial, and sustainability metrics to assess organizational performance comprehensively (*Sousa et al. 2006; Singh & Pillai, 2021a*). Financial metrics, such as ROI and revenue growth, remain foundational but must be contextualized with ESG costs. ESG scores positively impact financial performance indicators like ROA and ROE, indicating improved profit margins through cost reductions and revenue growth (*Fernandez Guadano & Sarria Pedroza, 2018*).

Nonfinancial metrics, such as Net Promoter Scores (NPS), bridge ESG initiatives and stakeholder expectations, correlating with ethical branding and customer loyalty (*Johnson & Lee, 2022*). ESG practices also enhance brand reputation, expand market share, and improve access to green financing, driving long-term growth (*D'Amato et al. 2023*). Strong ESG performance mitigates reputational risks and improves operational agility by embedding sustainability into core workflows (*Gualandris et al. 2015*).

Value Creation

ESG practices contribute to multidimensional value creation, encompasses economic, social, environmental, and stakeholder aspects. Economic value is generated through cost savings and revenue growth from sustainable products, with SMEs adopting renewable energy reports lower operational costs (*Lopez Perez et al. 2021*). Social value arises from initiatives that improve community relations and employee satisfaction,

foster inclusive workplaces and reducing social risks (*Kutzschbach et al. 2021; D'Amato et al. 2023*). Digital technologies, such as social media, further enhance stakeholder engagement and value creation (*Soomro et al. 2024*).

Stakeholder value is built on trust and collaboration, with transparent ESG practices strengthening relationships with customers, investors, and suppliers (*Ansong, 2017*). ESG practices also mitigate risks and enhance corporate valuation, emphasizing their role in long-term value creation (*Qin Ma, 2023*). Overall, the integration of ESG practices and digital technologies into business strategies is a key driver of sustainable value creation, particularly in the Indian SME context, which remains underexplored.

The literature on Multidimensional Performance Measures (MDP) reveal the absence of detailed studies on the application, integration, and impact of MDP within Indian SMEs, particularly the mediating role of MDP in the relationship between ESG practices and value creation in SMEs. There is insufficient empirical evidence on the challenges Indian SMEs face in adopting MDP and the role of digital technologies in this process. Additionally, the literature does not adequately address how cultural, regulatory, and economic factors in India influence MDP adoption and effectiveness. There is also a lack of understanding of the mechanisms by which MDP leads to value creation in Indian SMEs and the adaptability of MDP frameworks to changing stakeholder expectations. Hence, addressing this gap would provide valuable insights into optimizing MDP for SMEs in India.

Research objectives

The research objective aims to address the problem statement by examining the impact of ESG practices on multidimensional performance

measures and value creation in SMEs, exploring the mediating role of multidimensional performance measures in the relationship between ESG practices and value creation. Based on the recent literatures the following hypotheses can be developed.

H1: ESG Practices Positively Influence the Multidimensional Performance Measures of SMEs.

H2: Multidimensional performance measures have a significant positive effect on value creation.

H3: ESG Practices Positively Influence the Value Creation of SMEs.

H4: Multidimensional Performance Measures Positively Mediate the Relationship between ESG Practices and Value Creation in SMEs.

Research Methodology

This study adopts a mixed methods approach combining descriptive analysis and causal inference to evaluate ESG practices in SMEs with MDP metrics and subsequent value creation. The research focus on SMEs in Sidco Industrial Estate, Ambattur Thiruvallur District, used stratified random sampling to ensure sectoral representation within the SME population for cross-industry analysis of ESG practices. From a sample frame of 1,589 units, 320 respondents were selected to ensure representativeness. Primary data were gathered through structured questionnaires, supplemented by secondary data from scholarly literature and industry reports. This triangulation of data sources enhances the methodological rigor and validity of the findings, as noted by Fabiana et al. (2023). The study utilizes ESG practices (Ilze Zumente & Julija Bistрова, 2021), multidimensional performance measures (Asma Shabbir, 2022), and value creation (IIRC, 2020) as

key variables and employs a structured questionnaire, Likert-scale items with pilot test confirms high internal consistency (Cronbach's $\alpha = 0.85$) ensures instrument reliability and participant anonymity.

Analysis and Discussion

Participant profile

The descriptive statistics of participants profile reveals the demographic characteristics of sampled SMEs, essential for understanding ESG practices and value creation. The sample includes 40.6% service sector firms, 35.0% agriculture, and 24.4% industry, aligning with Wang & Esperança (2023) stated that service oriented SMEs prioritize ESG factors like customer privacy. A significant portion (65.9%) are young firms (10 years or younger) consistent with Omri et al. (2024) highlights challenges in ESG implementation due to limited resources. Most firms (35.3%) employ 21-40 individuals, indicating small to medium size, with Singh & Pillai (2021) noted that underdeveloped governance structures hinder ESG efforts. Top-level managers (43.1%) dominate emphasizing leadership commitment in ESG adoption (Kutzschbach et al. 2021) while lower middle manager representation (22.5%) may indicate execution gaps. Respondents with 6-15 years of experience (40.9%) can enhance strategic ESG planning, although Zhou et al. (2023) do not directly link experience to ESG strategy. Overall, these characteristics emphasis the need for tailored ESG frameworks to address sector specific challenges and leverage leadership commitment, particularly for younger service sector firms. Future research should explore how these factors influence ESG strategy effectiveness in diverse contexts.

Measurement Model Assessment

Construct validity assessed using Confirmatory Factor Analysis (CFA) that confirms the measurement instruments accurately reflect the theoretical constructs, with satisfactory fit indices: CFI = 0.92, TLI = 0.90, and RMSEA = 0.05 (Table 3). Composite reliability ranged from 0.76 to 0.94, exceeds the 0.70 benchmark with significant factor loadings at the 5% level establishes reliable constructs (Table 1).

Discriminant validity evaluated using the Fornell & Larcker Criterion and the Heterotrait-Monotrait

(HTMT) Ratio, reveals that the square root of the Average Variance Extracted (AVE) for each constructs exceeded its correlations with other constructs. The highest HTMT value was 0.83, below the 0.90 threshold, support the discriminant validity of the measurement model in Table 2. Convergent validity confirmed as AVE values exceeded the 0.50 threshold, indicates that the constructs explain over 50% of the variance in the respective dimensions (Table 1).

Table 1: Assessment of Measurement Model

| Items | Stand. Estimate | Cronbach's alpha | Average variance extracted (AVE) | Composite reliability (CR) |
|---------------|-----------------|------------------|----------------------------------|----------------------------|
| ENVTOTAL | 0.874 | 0.867 | 0.690 | 0.869 |
| SOCLTOTAL | 0.826 | | | |
| GOVERTOTAL | 0.791 | | | |
| VCSHAREHOLDER | 0.832 | 0.931 | 0.737 | 0.933 |
| VCEMPLOYEE | 0.940 | | | |
| VCCUSTOMER | 0.955 | | | |
| VCSUPPLIER | 0.762 | | | |
| VCCOMMUNITY | 0.913 | | | |
| OPERATIONS | 0.725 | 0.757 | 0.512 | 0.759 |
| COMMUNITY | 0.704 | | | |
| INNOVATION | 0.718 | | | |
| PROFIT | 0.868 | 0.874 | 0.877 | 0.781 |
| WEALTH | 0.897 | | | |

Table 2: HTMT Ratio of Correlations

| Heterotrait-Monotrait Ratio of Correlations | | | | |
|---|-------|----------------|---------------|-----------|
| | ESG | VALUE CREATION | NON FINANCIAL | FINANCIAL |
| ESG | 0.831 | | | |
| VALUE CREATION | 0.831 | 0.883 | | |
| NONFINANCIAL | 0.775 | 0.838 | 0.715 | |
| FINANCIAL | 0.579 | 0.640 | 0.681 | 0.883 |

Structural Model Assessment

The structural model evaluated using various fit indices includes CMIN/DF = 2.745, GFI = 0.979, CFI = 0.970, TLI = 0.960, SRMR = 0.030, and RMSEA = 0.054. The model fit indices fell within the acceptable ranges indicates a good fit for the structural model (table 3). The R-squared value for value creation was 0.74 suggest that 74% of the variance in value creation is accounted for by the independent variables, align with findings from Xuan Li et al. (2023) regarding the significant impact of ESG practices on firm value.

- ESG practices have positively influence the Multidimensional performance measures as Nonfinancial Performance NONFIN $\beta = 0.637$, $t = 8.65$, $p < .001$ and Financial Performance FIN $\beta = 0.594$, $t = 9.72$, $p < .001$, support the hypothesis H1 (table 3). This finding suggests that organizations implementing ESG strategies experience improved performance metrics in both financial and nonfinancial dimensions. This aligns with the work of Friede et al. (2015) identified a reliable positive correlation between ESG initiatives and overall performance, thereby reinforce the idea that

effective ESG practices lead to better organizational outcomes.

- Multidimensional performance measures have a significant positive effect on value creation as NONFIN $\beta = 0.468$, $t = 4.28$, $p < .001$ and FIN $\beta = 0.118$, $t = 2.11$, $p < .035$, support the hypothesis H2 (table 3). This result highlights the essential function of performance metrics in converting ESG efforts into tangible value for SMEs. Sanchez et al. (2020) indicate that organizations with strong performance measures are more capable of leverage ESG initiatives for value creation thereby reinforces the importance of performance as a mediating factor in this relationship.
- ESG practices have a significant positive effect on value creation as $\beta = 0.384$, $t = 4.48$, $p < .001$, support the hypothesis H3 (table 3). This finding signifies that SMEs that prioritize ESG initiatives can directly enhance the value creation efforts. Eccles et al. (2014) accentuate that effective ESG practices not only improve financial performance but also enhance stakeholder value endorsing the notion that ESG is integral to sustainable value creation in SMEs.

Table 3 SEM Assessment Model

| Hypothesized Relationship | Betas | t-value | p-value | Decision |
|---|-------|---------|---------|-----------|
| ESG-> VC | 0.384 | 4. | < .001 | SUPPORTED |
| ESG->NONFIN | 0.637 | 8.65 | < .001 | SUPPORTED |
| ESG->FIN | 0.594 | 9.72 | < .001 | SUPPORTED |
| NONFIN-> VC | 0.468 | 4.28 | < .001 | SUPPORTED |
| FIN-> VC | 0.118 | 2.11 | < .035 | SUPPORTED |
| R-Square | 0.74 | | | |
| Value Creation | | | | |
| Model Fit CMIN/DF =2.745, the goodness of fit (GFI) =0.979, CFI=0.970, TLI=0.960, SRMR=0.030 and RMSEA=0.054. | | | | |

Mediation Analysis Results

Direct Effects Analysis

The direct effects analysis confirms a strong positive association between ESG practices and value creation ($\beta = 0.396$, $p < .001$) in table 4. This aligns with Eccles et al. (2014) indicate that ESG initiatives enhance firm performance by improving stakeholder trust and operational efficiency, suggest a robust direct effect of ESG on value creation ($\beta = 0.384$, $p < .001$), support the argument that SMEs adopting ESG practices can achieve tangible financial gains, such as increased profitability ($\beta = 0.868$) and wealth generation ($\beta = 0.897$). Thus, SMEs actively engage in ESG practices are likely to experience enhanced value creation, reinforce the notion that sustainability initiatives lead to financial benefits.

Indirect Effects Analysis

The indirect effects analysis reveals significant mediation effects through nonfinancial ($\beta = 0.468$, $p < .001$) and financial ($\beta = 0.118$, $p = 0.035$) performance pathways (table 4). Nonfinancial factors, such as community engagement and innovation, strongly mediate ESG's effect on value creation, align with Hsu et al. (2020) found that ESG practices enhance firm value through improved stakeholder relationships. Conversely,

financial mediation represents weaker effects; consistent with Hsu et al. (2020) that financial outcomes are secondary compared to nonfinancial ESG drivers. This highlights that ESG's value creation is more closely tied to intangible assets than short-term financial gains.

Total Effects Analysis

The total effects analysis (table 4), reveals a strong overall impact of ESG practices on value creation ($\beta = 0.643$, $p < .001$) indicate that both direct and indirect pathways contribute to firm value. This aligns with Friede et al. (2015) a significant positive correlation between ESG practices and financial performance. However, Porter and Kramer (2011) caution that the total effect may mask complexities, such as potential diminishing returns on ESG investments if not strategically implemented.

Further, variations in impact on different stakeholder groups are evident (table 5), with the highest mediation effect observed for shareholders ($\beta = 0.108$), followed by customers ($\beta = 0.094$) and communities ($\beta = 0.0825$). Freeman et al. (2020) emphasize that ESG's value creation is maximized when firms address the unique needs of high-priority stakeholders, reinforcing the importance of customized ESG strategies.

Table 4 Mediation Analysis

| Total effect (ESG->VC) | | Direct effect (ESG->VC) | | Indirect effect of on (ab) | | | | | |
|---------------------------|---------|----------------------------|---------|----------------------------|-------------|--------|---------|---------|---------------------|
| Coefficient | p value | Coefficient | p value | | Coefficient | SD | T value | p value | BI [2.5%; 97.5%] |
| 0.643 | 0.001 | 0.396 | 0.001 | H2: ESG->MDP- >VC | 0.247 | 0.0306 | 8.06 | 0.001 | 0.189; 0.306 |

Table 5 Mediation Effect on Each Stakeholder

| Total effect (ESG->VCSH) | | Direct effect (ESG->VCSH) | | Indirect effect of on (ab) | | | | | |
|-----------------------------|---------|------------------------------|---------|----------------------------|-------------|---------|---------|---------|------------------|
| Coefficient | p value | Coefficient | p value | | Coefficient | SD | T value | p value | BI [2.5%; 97.5%] |
| 0.1597 | 0.001 | 0.1083 | 0.001 | H2: ESG->MDP->VCSH | 0.0514 | 0.00886 | 5.80 | 0.001 | 0.0340; 0.0688 |
| 0.1169 | 0.001 | 0.0816 | 0.001 | H2: ESG->MDP->VCEMP | 0.0353 | 0.00540 | 6.53 | 0.001 | 0.0247; 0.0459 |
| 0.1410 | 0.001 | 0.0941 | 0.001 | H2: ESG->MDP->VCCUST | 0.0468 | 0.00627 | 7.47 | 0.001 | 0.0346; 0.0591 |
| 0.1369 | 0.001 | 0.0779 | 0.001 | H2: ESG->MDP->VCSUP | 0.0590 | 0.00746 | 7.91 | 0.001 | 0.0444; 0.0736 |
| 0.1267 | 0.001 | 0.0825 | 0.001 | H2: ESG->MDP->VCCOMU | 0.0441 | 0.00580 | 7.61 | 0.001 | 0.0328; 0.0555 |

Research Findings

- ESG practices results on multidimensional performance measures (financial ($\beta = 0.594$) and nonfinancial performance ($\beta = 0.637$)) and value creation in SMEs endorse the findings of Friede et al. (2015).
- The MDP measures influence on value creation (NONFIN $\beta = 0.468$; FIN $\beta = 0.118$) enrich ESG initiatives into tangible benefits as noted by Sanchez et al. (2020).
- The direct relation between ESG practices and value creation ($\beta = 0.384$) specify that ESG initiatives produce tangible financial benefits essential for sustainable organizational success strengthen the perspectives of Eccles et al. (2014).
- Mediation analysis divulge the relationship between ESG practices and value creation ($\beta = 0.247$) that ESG practices intensify value indirectly through improved performance metrics as acclaimed by Hsu et al. (2020).
- The total effect of ESG implementation on value creation is strong ($\beta = 0.643$) and fortify the holistic view of ESG in both direct and indirect effects contribute to firm

value creation (Friede et al. 2015).

- Indirect effects of ESG initiatives vary across stakeholders, with shareholders experiencing the highest mediation effect, followed by customers, communities, employees, and suppliers. This highlights the need for tailored strategies to maximize value creation for each group (Zhou et al. 2022b).

Conclusion

This study enriches the current literature on performance measurement systems by clarifying the mediating role of multidimensional performance measures between ESG practices and value creation (Xuan Li et al. 2023). The findings highlight the significance of both direct and indirect pathways in assessing the influence of sustainability initiatives on corporate value. Additionally, ESG integration into core strategies as a strategic imperative rather than merely a compliance requirement for sustainability contributes to the ongoing discussion about the relevance of ESG and sustainable value creation (Eccles et al. 2021).

The study insists on SMEs prioritize ESG initiatives as a

strategic approach to enrich organizational performance and create value. Managers are urged to incorporate ESG considerations into business strategies to meet stakeholder expectations and secure competitive advantages (Porter & Kramer, 2011; Haffar et al. 2022). The results signify that inclusion of nonfinancial performance indicators in performance measurement systems can maximize benefits of ESG initiatives. Finally, investing in training and resources to develop ESG capabilities is essential as it can enhance operational efficiencies and drive innovation (Bennett et al. 2023).

Recommendations

- The findings encourage the execution of ESG practices among SMEs through incentives, training programs, resource commitment, networking, and innovation to cultivate sustainability oriented culture.
- Policymakers should consider developing frameworks that facilitate the incorporation of ESG factors in SMEs operations thereby promoting corporate accountability and sustainability within the economy (Sullivan & Mackenzie, 2017; Goyal et al. 2023).
- Additionally, establish a regulatory framework that supports effective sustainable practices and aligns with sustainability reporting can enhance societal and economic goals by promoting environmental conservation and social equity (Monica Singhania et al. 2023).

Limitations of the study

The study sample is limited to SMEs in the Ambattur Industrial Estate, Thiruvallur District, restricts generalizability to other regions and sectors. Furthermore, the cross-sectional design and lack of interview method hinder the ability to draw causal inferences and gain deeper insights into the role of multidimensional performance measures in ESG and value creation.

Scope for Future Research

The future research should broaden the sample to include SMEs from various regions and industries, utilize longitudinal studies to assess long-term ESG effects, and explore qualitative insights on ESG implementation. Additionally, incorporate variables like digital transformation, AI, green innovation, and government subsidies, could enhance understanding and reporting of

SMEs performance.

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