IJARSCT
International Journal of Advanced Research in Science, Communication and Technology
International Open-Access, Double-Blind, Peer-Reviewed, Refereed, Multidisciplinary Online Journal
ISSN: 2581-9429
Volume 6, Issue 4, September 2026
Impact Factor: 8.2

Impact of ESG Disclosures (BRSR) on Cost of Equity: A Conceptual Study of Indian Listed Firms

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Abstract: *Environmental, Social, and Governance (ESG) disclosures have emerged as a critical component of corporate reporting in recent years, particularly with the introduction of Business Responsibility and Sustainability Reporting (BRSR) by the Securities and Exchange Board of India for the top 1000 listed companies in India. This shift reflects a growing emphasis on transparency, accountability, and sustainable business practices in financial markets. The present study conceptually examines the impact of ESG disclosures on the cost of equity of Indian listed firms.*

Drawing on established financial theories such as the Capital Asset Pricing Model and Information Asymmetry, the paper argues that enhanced ESG disclosure improves the quality and quantity of information available to investors. This, in turn, reduces information asymmetry between firms and stakeholders, lowers perceived investment risk, and leads to a decline in the required rate of return on equity.

The study further develops a comprehensive conceptual framework linking ESG disclosures to financial outcomes through mediating variables such as transparency, investor confidence, and risk perception. It also integrates insights from behavioural and sustainability perspectives to explain how ESG reporting influences investor decision-making in emerging markets like India.

The findings of the study suggest that firms with robust ESG disclosure practices are likely to benefit from reduced financing costs and improved market reputation. The paper highlights important implications for corporate managers, investors, and policymakers, emphasising the need for standardized and high-quality ESG reporting. It also provides a foundation for future empirical research on the relationship between ESG performance and cost of capital in the Indian context..

Keywords: ESG Disclosures, BRSR, Cost of Equity, Information Asymmetry, Sustainable Finance, Corporate Governance

I. INTRODUCTION

In recent years, sustainability and responsible business practices have become integral components of corporate strategy, driven by increasing stakeholder awareness, regulatory pressures, and the need for long-term value creation. Organizations are no longer evaluated solely on the basis of financial performance but also on their environmental stewardship, social responsibility, and governance standards. This shift has led to the growing importance of Environmental, Social, and Governance (ESG) disclosures in corporate reporting across global and emerging markets.

In the Indian context, the Securities and Exchange Board of India has taken a significant step by introducing the Business Responsibility and Sustainability Reporting (BRSR) framework as a mandatory requirement for the top 1000 listed companies. This initiative aims to enhance the quality, consistency, and comparability of ESG-related disclosures, thereby promoting greater transparency and accountability among firms. The BRSR framework reflects a

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broader movement toward sustainable finance and responsible investing, aligning Indian corporate reporting practices with global standards.

Traditional financial theories, such as those based on profit maximization and market efficiency, primarily focused on quantitative financial metrics to evaluate firm performance. However, with the evolution of financial markets and increased access to information, modern investors increasingly incorporate non-financial indicators into their decision-making processes. ESG disclosures serve as a critical source of such information, providing insights into a firm's risk management practices, ethical standards, and long-term sustainability prospects.

From a theoretical perspective, enhanced disclosure reduces Information Asymmetry between firms and investors, thereby improving market efficiency and investor confidence. When investors perceive lower uncertainty and risk, they tend to demand lower returns, which ultimately reduces the firm's cost of equity capital. In this context, ESG disclosures are not merely compliance tools but strategic instruments that can influence financial outcomes.

Against this backdrop, the present study seeks to conceptually examine the relationship between ESG disclosures, particularly through BRSR, and the cost of equity of Indian listed firms. The study aims to bridge the gap between sustainability reporting and financial decision-making by developing a conceptual framework that explains how ESG practices impact investor perception, risk assessment, and ultimately, the cost of capital.

II. LITERATURE REVIEW

The relationship between Environmental, Social, and Governance (ESG) disclosures and the cost of equity has attracted significant attention in recent financial literature. This section reviews key theoretical and empirical studies to establish the conceptual foundation of the study.

ESG Disclosure and Cost of Equity

One of the most influential studies by Sadok El Ghoul et al. (2011) found that firms with superior corporate social responsibility (CSR) performance experience a lower cost of equity capital. The study highlights that investments in environmental practices, employee relations, and product responsibility significantly reduce financing costs by lowering perceived risk among investors (El Ghoul et al., 2011).

Similarly, Dan S. Dhaliwal et al. (2011) demonstrated that firms initiating voluntary ESG disclosures benefit from a reduction in the cost of equity, as such disclosures enhance transparency and stakeholder confidence (Dhaliwal et al., 2011).

Further supporting this view, George Serafeim and colleagues have documented a negative relationship between ESG performance and cost of capital, suggesting that sustainability practices act as a risk-mitigating mechanism and improve firm valuation (Eccles, Ioannou & Serafeim, 2014).

ESG, Risk Reduction, and Investor Perception

The theoretical explanation for the ESG–cost of equity relationship is grounded in risk mitigation. Firms with strong ESG practices are perceived as less risky due to better governance, ethical practices, and long-term sustainability. As a result, investors demand lower returns (Aouadi & Marsat, 2018).

Research shows that ESG acts as a "trust premium," where improved disclosure reduces uncertainty and enhances investor confidence (Lins, Servaes & Tamayo, 2017).

However, recent studies also indicate that poor ESG performance or ESG-related reputational risks can increase the cost of equity, highlighting the importance of both quality and credibility of disclosures (Giese et al., 2019).

Role of Information Asymmetry

The concept of Information Asymmetry plays a central role in explaining the impact of ESG disclosures. When firms provide detailed ESG information, the gap between internal and external stakeholders reduces, leading to better-informed investment decisions.

Studies suggest that ESG disclosures improve transparency and reduce communication conflicts, which ultimately lowers the required rate of return by investors (Diamond & Verrecchia, 1991; Healy & Palepu, 2001).

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Furthermore, ESG reporting complements financial disclosures, strengthening the overall information environment and enhancing market efficiency (Verrecchia, 2001).

Sustainability Performance and Financial Outcomes

Research on sustainability performance indicates that firms with strong ESG practices not only reduce their cost of equity but also improve overall financial performance. ESG factors contribute to better risk management, operational efficiency, and long-term value creation (Friede, Busch & Bassen, 2015).

Empirical studies confirm that both financial (economic) and non-financial (ESG) performance jointly influence the cost of capital, suggesting that investors evaluate firms holistically rather than relying solely on financial metrics (Clark, Feiner & Viehs, 2015).

Mixed Evidence and Contradictory Findings

Despite the general consensus, some studies present mixed or contradictory findings. For instance, certain research in emerging markets suggests that ESG disclosures may not always lead to a reduction in cost of equity due to lower investor awareness or inconsistent reporting standards (Boubaker, Cellier & Manita, 2020).

Additionally, the impact of ESG varies across industries and regions, indicating that contextual factors such as regulatory environment, market maturity, and investor preferences play a crucial role (Fatemi, Glaum & Kaiser, 2018).

ESG in Emerging Markets and Indian Context

Most ESG-related studies are concentrated in developed economies, while research in emerging markets like India remains limited. The introduction of Business Responsibility and Sustainability Reporting (BRSR) by the Securities and Exchange Board of India marks a significant step toward improving ESG disclosure standards in India.

However, the relatively recent implementation of BRSR means that there is limited academic literature examining its direct impact on financial variables such as cost of equity. This creates a need for conceptual and empirical studies in the Indian context.

Summary of Literature

The literature broadly suggests that:

ESG disclosures generally reduce the cost of equity

The relationship is mediated by risk perception and information asymmetry

There is mixed evidence in emerging markets

There is a lack of conceptual frameworks integrating ESG and financial theories

Conclusion of Literature Review

The existing literature establishes a strong theoretical and empirical link between ESG disclosures and the cost of equity. However, gaps remain in understanding this relationship in emerging markets and within structured frameworks like BRSR. This study attempts to address these gaps by developing a conceptual model specific to Indian listed firms.

Research Gap

Although extensive research has been conducted globally on ESG and financial performance, several gaps remain:

Most studies are empirical and focused on developed markets, with limited conceptual exploration in the Indian context.

There is insufficient integration of financial theories like Capital Asset Pricing Model with ESG disclosure frameworks.

Limited research explains the mechanism (how ESG reduces cost of equity) through mediating factors like Information Asymmetry and risk perception.

The BRSR framework is relatively new, and conceptual studies linking it with cost of capital are still scarce.

Lack of a clear conceptual model combining ESG, investor perception, and financial outcomes.

This study attempts to fill these gaps by developing a theory-driven conceptual framework in the Indian context.

Problem Statement

Despite the growing importance of Environmental, Social, and Governance (ESG) disclosures, there remains a lack of clarity regarding their direct impact on financial variables such as the cost of equity, especially in emerging markets like India. While the introduction of Business Responsibility and Sustainability Reporting (BRSR) by the Securities

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and Exchange Board of India aims to enhance transparency and standardization, many firms still treat ESG disclosures as a compliance requirement rather than a strategic financial tool.

Moreover, traditional financial models largely overlook non-financial disclosures, creating a disconnect between sustainability practices and financial decision-making. Investors often face challenges in interpreting ESG information, leading to inconsistencies in how such disclosures influence risk perception and required returns.

Therefore, the key problem addressed in this study is:

Do ESG disclosures (through BRSR) significantly influence the cost of equity of Indian listed firms, and through what conceptual mechanisms does this relationship operate?

III. OBJECTIVE

- To understand the concept of ESG and BRSR disclosures
- To examine the impact of ESG disclosures (BRSR) on the cost of equity of Indian listed firms from a conceptual perspective
- To examine the role of information asymmetry in financial markets
- To develop a conceptual framework linking ESG disclosure and financial outcomes

IV. RESEARCH METHODOLOGY

Research Design

The present study adopts a conceptual and descriptive research design, focusing on analyzing the theoretical relationship between ESG disclosures and the cost of equity. The study is primarily qualitative in nature and aims to synthesize existing literature, financial theories, and regulatory frameworks to develop a comprehensive conceptual model.

Unlike empirical studies that rely on statistical testing, this research emphasizes theoretical reasoning and logical interpretation to explain how ESG disclosures influence financial outcomes. The study also integrates interdisciplinary perspectives from finance, sustainability, and corporate governance.

Nature of the Study

Conceptual Research
Descriptive and analytical approach
Theory-driven framework development
Non-empirical

Data Sources

The study is based on secondary data sources, including:
Peer-reviewed journal articles on ESG and cost of capital
Reports and guidelines issued by the Securities and Exchange Board of India
Corporate sustainability and ESG reports
Books, working papers, and academic publications
Industry reports on sustainable finance

These sources provide a comprehensive foundation for understanding the evolving relationship between ESG disclosures and financial performance.

V. THEORETICAL FRAMEWORK

The present study is grounded in key financial and economic theories that explain the relationship between information, risk, and return. These theories provide a strong conceptual foundation to understand how ESG disclosures, particularly through the BRSR framework, influence the cost of equity of firms.

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Capital Asset Pricing Model (CAPM)

The Capital Asset Pricing Model (CAPM) is a fundamental theory in finance that explains the relationship between risk and expected return. According to CAPM, the expected return on an investment is directly proportional to its systematic risk (beta). Investors demand higher returns for taking higher risk.

Relevance to the Study

ESG disclosures help reduce perceived risk by providing additional non-financial information.

Firms with strong ESG performance are considered less risky due to better governance, sustainability, and ethical practices.

As risk decreases, the required rate of return (cost of equity) also decreases.

Thus, ESG disclosures indirectly influence the cost of equity through their impact on risk perception, as explained by CAPM.

Efficient Market Hypothesis (EMH)

The Efficient Market Hypothesis (EMH) states that financial markets are efficient in reflecting all available information in asset prices. It assumes that investors make rational decisions based on available data.

Relevance to the Study

ESG disclosures increase the availability and quality of information in the market.

Better information leads to more accurate pricing of securities.

In an efficient market, ESG information gets incorporated into stock prices, affecting investor expectations and returns.

Therefore, ESG disclosures contribute to improving market efficiency, which influences investment decisions and cost of capital.

Information Asymmetry

Information asymmetry occurs when one party (usually company management) has more or better information than investors. This creates uncertainty and increases perceived risk.

Relevance to the Study

ESG disclosures reduce the information gap between firms and investors.

Improved disclosure enhances transparency and trust.

Lower information asymmetry reduces uncertainty, leading to better investor confidence.

When investors have more reliable information, they require lower returns, reducing the cost of equity.

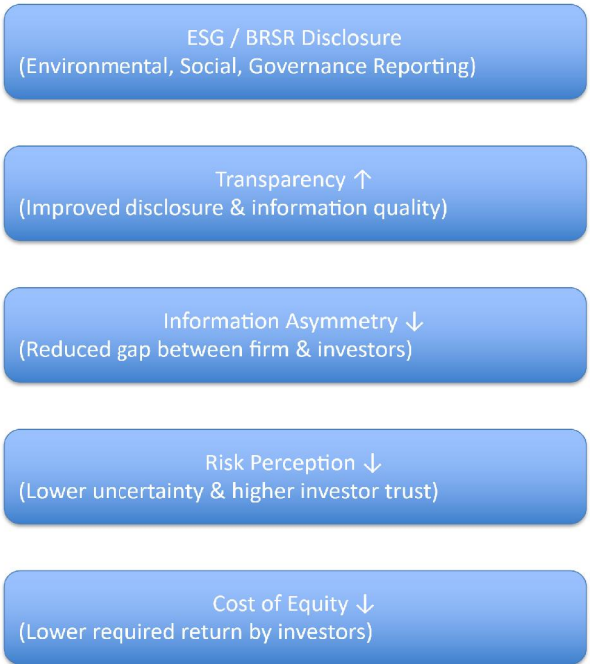
VI. CONCEPTUAL RELATIONSHIP EXPLAINED

The study integrates the above theories into a logical framework that explains how ESG disclosures impact financial outcomes:

Conceptual Flow

ESG / BRSR Disclosure → Transparency ↑ → Information Asymmetry ↓ → Risk Perception ↓ → Cost of Equity ↓

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Step-by-Step Explanation

1. ESG / BRSR Disclosure

Firms disclose environmental, social, and governance information through BRSR.

This includes data on sustainability practices, governance standards, and social responsibility.

2. Increase in Transparency

ESG disclosures improve the quality and quantity of information available to stakeholders.

Transparency reduces uncertainty regarding firm operations and future performance.

3. Reduction in Information Asymmetry

Better disclosure reduces the gap between internal (management) and external (investors) information.

Investors gain a clearer understanding of the firm's risk profile.

4. Decrease in Risk Perception

With more reliable information, investors perceive the firm as less risky.

ESG-compliant firms are seen as more stable, ethical, and sustainable.

5. Reduction in Cost of Equity

According to CAPM, lower perceived risk leads to lower expected returns.

As a result, firms benefit from a lower cost of equity capital.

The theoretical framework demonstrates that ESG disclosures act as a bridge between non-financial reporting and financial outcomes. By improving transparency and reducing information asymmetry, ESG practices influence investor perception and ultimately reduce the cost of equity.

VII. FINDINGS OF THE STUDY

Based on the conceptual analysis, theoretical foundations, and extensive review of literature, the study reveals that ESG disclosures have a significant influence on the cost of equity of firms. The findings indicate a negative relationship between ESG disclosures and the cost of equity, suggesting that firms with higher levels of transparency in

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environmental, social, and governance practices are likely to benefit from lower required returns by investors. This relationship is primarily driven by the role of ESG disclosures in reducing information asymmetry, as improved availability and reliability of non-financial information enable investors to make more informed decisions.

Furthermore, the study identifies risk perception as a key mediating factor in this relationship. Firms demonstrating strong ESG performance are perceived as less risky due to better governance practices, ethical standards, and long-term sustainability orientation, which ultimately reduces the expected rate of return demanded by investors. Enhanced ESG reporting also contributes to increased investor confidence by providing greater clarity regarding a firm's operations, future prospects, and risk management practices.

In the Indian context, the introduction of BRSR by the Securities and Exchange Board of India has played a transformative role in shifting ESG disclosures from a mere compliance requirement to a strategic financial tool that can influence capital costs. The study further validates the relevance of traditional financial theories such as the Capital Asset Pricing Model and the Efficient Market Hypothesis in explaining the ESG–cost of equity relationship when extended to incorporate sustainability dimensions.

Additionally, the findings emphasize that not only the presence but also the quality, credibility, and consistency of ESG disclosures are critical in determining their effectiveness. Poor-quality or inconsistent disclosures may fail to reduce uncertainty and could even increase perceived risk. Lastly, the study highlights that in emerging markets like India, the impact of ESG disclosures is still evolving due to differences in investor awareness, reporting standards, and market maturity, indicating the need for further development and empirical validation in this area.

VIII. CONCLUSION

The study concludes that ESG disclosures, particularly through the BRSR framework, play a significant role in influencing the cost of equity of Indian listed firms from a conceptual perspective.

By integrating financial theories with sustainability practices, the research demonstrates that ESG disclosures improve transparency, reduce information asymmetry, and lower perceived risk among investors. This ultimately leads to a reduction in the required rate of return on equity.

The study also highlights that ESG reporting is no longer merely a regulatory obligation but has emerged as a value-creating mechanism that enhances firm reputation, strengthens investor trust, and improves access to capital.

However, the effectiveness of ESG disclosures in reducing cost of equity depends largely on the quality, comparability, and credibility of reporting, especially in emerging markets like India where ESG practices are still developing.

Overall, the study provides a strong conceptual foundation linking sustainability reporting with financial outcomes and emphasizes the growing importance of ESG in modern financial decision-making.

IX. RECOMMENDATIONS

Based on the findings and conclusions, the following recommendations are proposed:

For Corporate Managers

Firms should treat ESG disclosures as a strategic financial tool rather than mere compliance.

Focus on high-quality, transparent, and consistent reporting under BRSR.

Integrate ESG practices into core business strategy to improve long-term value creation.

Enhance internal systems for accurate ESG data measurement and reporting.

For Investors

Investors should incorporate ESG factors into investment decision-making models.

Evaluate not only financial performance but also sustainability and governance practices.

Develop better frameworks to interpret ESG disclosures for risk assessment.

For Policymakers and Regulators

The Securities and Exchange Board of India should continue strengthening BRSR guidelines to ensure standardization and comparability.

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Promote awareness and education regarding ESG among investors and firms.
Encourage third-party assurance of ESG reports to enhance credibility.

For Future Researchers

Conduct empirical studies to validate the conceptual framework using firm-level data.
Examine industry-wise differences in ESG impact on cost of equity.
Explore additional mediating variables such as: Corporate reputation , Investor sentiment, Market volatility
Study the long-term impact of BRSR adoption on financial performance in India.

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