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The Impact of ESG Performance on Cross-Border Investment in Developing Countries

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Abstract. In the global push for sustainable development, ESG (Environmental, Social, Governance) has become a key metric for assessing enterprises and nations. Cross-border investment, a core part of global economic interaction, is increasingly influenced by the ESG performance of investment destinations. Developing countries are vital in global capital competition, and their ability to attract cross-border investment shapes their economic transformation. Yet, research here is limited. China, as the largest developing country and a major foreign capital recipient, has both common traits of developing nations (e.g., evolving ESG systems) and unique ones (e.g., policy-driven ESG progress). Thus, studying China's case to explore how ESG affects cross-border investment is highly meaningful. This study focuses on the link between corporate ESG performance and foreign capital inflows. It aims to strengthen the theoretical framework for ESG and cross-border investment in developing countries, offer insights for Chinese policymakers and enterprises, and guide other developing nations in balancing sustainability and capital attraction. The analysis reveals no statistically significant correlation between corporate ESG ratings and foreign investment inflows during the observation period, suggesting that in the current developmental stage of China's high-tech industry, traditional factors such as policy support, market growth potential, and strategic alignment with national priorities may outweigh ESG considerations in attracting foreign capital.

Keywords: ESG, Cross-Border Investment, Developing Country

1. Introduction

Strong overall ESG (Environmental, Social, Governance) performance, or excellence specifically in the environmental (E) and governance (G) dimensions, significantly promotes transnational investment, particularly foreign direct investment (FDI), through several key mechanisms. The core of this influence lies in effectively mitigating investment risks. For instance, robust corporate environmental management practices reduce the potential for financial losses stemming from pollution incidents, litigation, or regulatory penalties [1]. At the national level, high-quality governance, characterized by effective corruption control and government efficiency, provides investors with a stable and predictable legal and institutional environment, thereby reducing political risk and the likelihood of default.

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Beyond risk reduction, superior ESG performance substantially enhances a firm's reputation and market attractiveness. Environmentally, the adoption of green technologies and sustainable practices helps build a responsible brand image, appealing to a growing base of environmentally conscious global consumers and investors. From a governance perspective, high levels of transparency and effective board structures are perceived as signals of high-quality management, bolstering confidence among international investors. Concurrently, the global policy landscape actively encourages enterprises with strong ESG credentials. Many countries and regions, through regulatory frameworks such as the Paris Agreement and the EU Taxonomy, provide tangible incentives like tax advantages, subsidies, and streamlined project approval processes, further catalyzing green investment [1-2].

Financially, strong ESG credentials, particularly reliable governance structures, improve a company's financing conditions. This translates into easier access to green credit, the ability to issue green bonds, and increased attraction of capital from institutional investors such as pension funds and dedicated ESG funds, which are increasingly integrating ESG factors into their core investment decisions [3]. Ultimately, this type of investment not only enhances a firm's capital accessibility but also strengthens its long-term profitability and international competitiveness by improving resource efficiency, lowering operational costs, and fostering green technology innovation, making it a more attractive investment target. Furthermore, a high level of ESG disclosure reduces information asymmetry between investors and firms, lowering the costs associated with cross-border due diligence. Internationally harmonized reporting standards further enhance transparency and comparability, creating smoother channels for the flow of transnational capital.

A predominant focus on developed economies characterizes the extant literature. Most studies concentrate on advanced markets such as the United States, the United Kingdom, and Germany, emphasizing the role of ESG in risk reduction and long-term return enhancement [4]. Research exploring how emerging markets leverage ESG practices to facilitate international expansion remains scarce, despite the distinctive ESG mechanisms and contextual logics present in these settings [5]. A portion of the literature does examine the relationship between ESG performance and cross-border investment in developing countries; however, the majority of these studies focus on how inward foreign investment influences the ESG practices of domestic firms, or how outward investment from developing countries is associated with their ESG profiles [6]. Conversely, relatively limited scholarly attention has been directed toward the inverse relationship—namely, how stronger ESG performance within developing countries may actively attract inbound cross-border investment. This one-sided emphasis has resulted in a notable gap regarding the proactive role of ESG as a pull factor for international capital, particularly in the context of emerging economies seeking to enhance their attractiveness to foreign investors.

This research addresses several underexplored dimensions in the existing literature by concentrating on the nexus between corporate ESG performance and cross-border investment within developing economies, with a specific emphasis on China’s high-tech sector. Unlike the predominant focus on developed markets, this study shifts scholarly attention toward a major developing economy, thereby extending the analytical framework of ESG-investment interactions into diverse institutional environments.

A distinctive feature of this paper lies in its reversal of the conventional causal direction examined in most prior studies. Rather than analyzing how foreign investment influences local ESG practices, it investigates whether and how robust ESG performance—particularly within leading high-tech firms such as Xiaomi, BYD, CATL, Tencent, and Baidu—can serve as an attracting

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mechanism for cross-border capital. This approach helps balance the scholarly discourse by highlighting the proactive role of ESG in shaping investment flows.

Furthermore, the study delves into a strategically critical yet under-researched industrial domain. The sample comprises firms that are not only market leaders but also operate within sectors—new energy, automotive manufacturing, digital platforms, and AI technologies—that are central to sustainable development and technological upgrading. Such a focus allows for a nuanced understanding of how ESG metrics operate within high-growth, innovation-driven industries in emerging economies.

By incorporating recent and firm-level ESG data (2021–2023) alongside foreign investment trends at the sectoral level, the analysis also offers temporal relevance and empirical specificity. This methodological approach helps illuminate whether ESG factors exert a meaningful influence on investment decisions in a dynamic and policy-shaped context such as China's.

Overall, this study contributes to a more comprehensive understanding of the strategic role of ESG performance in attracting foreign investment within developing countries—an area that remains theoretically and empirically overlooked, especially with regard to key industries and leading enterprises.

2. The impact of ESG performance on cross-border investment

This study employs some data on cases to examine the potential correlation between corporate ESG performance and foreign investment inflows in China's high-tech sector. The analysis utilizes datasets from authoritative sources to ensure reliability and validity.

ESG Rating Data: Firm-level ESG ratings for the selected enterprises (Xiaomi, BYD, CATL, Tencent, and Baidu) from 2021 to 2023 were sourced from MSCI ESG Ratings1, a globally recognized assessment system. Additionally, Wind ESG ratings and annual Corporate Social Responsibility (CSR) or ESG reports published by the companies themselves were used to cross-verify and supplement the data.

Foreign Investment Data: Sector-level data on foreign capital inflows into China's high-tech industry for the corresponding period were obtained from official Chinese sources, primarily the Ministry of Commerce of China (MOFCOM)27 and the National Bureau of Statistics of China. These institutions regularly release statistical bulletins on foreign direct investment (FDI), including breakdowns by industry.

Rationale for Enterprise Selection: The five enterprises—Xiaomi, BYD, CATL, Tencent, and Baidu—were selected as they are widely recognized as leading players in China's high-tech industry, representing core sectors such as consumer electronics, new energy vehicles, battery technology, and digital services. Their operational scale, market influence, and innovation drive make them representative for analyzing ESG-investment dynamics.

Some data from research was employed to assess whether variations in corporate ESG ratings exerted a significant influence on changes in foreign capital inflows. For instance, despite an improvement in BYD's ESG rating from B to A between 2021 and 2022, no consistent corresponding increase in foreign investment was observed. Similarly, a decline in CATL's rating from A to CCC during the same period was not associated with a systematic reduction in investment.

The research indicates no statistically significant correlation between the ESG performance of the sampled leading high-tech enterprises and the fluctuations in foreign investment inflows into China's high-tech sector during the observed period. For instance, an upgrade in BYD's ESG rating was not associated with a consistent increase in foreign investment, nor was a downgrade in CATL's rating accompanied by a systematic decrease.

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This lack of a clear association suggests that non-ESG factors likely play a more dominant role in attracting foreign capital within the current context of China's high-tech sector. The analysis points to several interconnected explanatory factors that may account for this weak correlation. Primarily, industrial policy and state guidance appear to exert a profound influence on capital allocation, with foreign investors potentially prioritizing alignment with national strategic directions and the market growth they foster over corporate ESG scores. Additionally, foreign investment decisions may be driven more by short-to-medium-term market entry strategies, profitability expectations, and technology acquisition goals rather than long-term sustainability considerations.

The unique social and governance contexts of Chinese firms also present challenges for international ESG rating systems. Factors crucial in China's institutional environment, such as contributions to "Common Prosperity" initiatives or the role of Party organizations in corporate governance, may be underrepresented or evaluated differently in existing frameworks. This localization gap could lead to a disconnect between international ESG scores and the aspects of corporate performance that are truly valued by both Chinese stakeholders and investors. Furthermore, although the selected leading firms disclose relatively more information, overall ESG disclosure quality and consistency across Chinese companies can vary, potentially leading investors to rely on other perceived more reliable indicators for decision-making.

The absence of a significant correlation between the ESG performance of major high-tech firms and foreign investment inflows in this study highlights the complex and context-specific nature of the ESG-investment nexus in developing economies like China. This finding suggests that for ESG to become a more influential factor in attracting foreign capital, merely improving ESG scores based on existing international frameworks might be insufficient. Instead, there appears to be a need for developing more localized and material ESG evaluation criteria that resonate with both international investors and domestic priorities, while also enhancing the quality, consistency, and transparency of ESG disclosures to build investor trust.

Policymakers and industry associations could play a role in better articulating the value of robust ESG practices within the broader national development strategy. Future research could explore these dynamics with broader industry coverage, longer time horizons, and incorporate firm-level FDI data if available. Comparative studies across different emerging economies would also be valuable to discern common patterns and unique national characteristics in the relationship between ESG performance and investment flows.

3. Conclusion

This study has examined the relationship between ESG performance and cross-border investment in the context of China's high-tech sector, focusing on five leading enterprises. The analysis reveals no statistically significant correlation between corporate ESG ratings and foreign investment inflows during the observation period, suggesting that in the current developmental stage of China's high-tech industry, traditional factors such as policy support, market growth potential, and strategic alignment with national priorities may outweigh ESG considerations in attracting foreign capital.

While limited by its focus on a single sector and reliance on aggregate investment data, this study provides a foundation for future research to explore ESG-investment dynamics across different industries, time periods, and emerging economies. Further investigation using firm-level investment data and comparative cross-country analysis would be particularly valuable in advancing our understanding of how ESG factors interact with investment decisions in varied institutional contexts.

Ultimately, as global sustainable finance continues to evolve, developing countries like China face both challenges and opportunities in shaping ESG systems that not only meet international

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expectations but also effectively support their unique developmental pathways and economic transformation goals.

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