The Impact Mechanisms and Optimization Strategies of ESG Pillars on Brokerage Firm Valuation

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ABSTRACT

ESG has gradually shifted from a corporate social responsibility issue to an important framework for evaluating the long-term value of companies in the capital market. For securities firms, ESG is not simply about image building or compliance disclosure, but can influence market valuation through risk control, customer trust, capital costs, and business structure. Unlike high-emission industries, the value of securities firms in the environmental dimension is more reflected in their green financial service capabilities; the social dimension is mainly reflected in customer protection, investor education, employee professional competence, and data security; and the governance dimension is directly related to compliance risk, internal control, and valuation discounts. Based on relevant ESG research, this paper analyzes the mechanism by which the three sub-indicators of environment, society, and governance affect the valuation of securities firms and proposes optimization strategies. The study argues that the focus of securities firms' ESG construction should not be limited to improving the overall score, but should emphasize the substantial connection between the sub-indicators and their main business, risk governance, and capital market intermediary functions.

Keywords: ESG; Securities Companies; Brokerage Valuation; Green Finance; Social Responsibility; Corporate Governance

1. INTRODUCTION

1.1 Research Background

In recent years, ESG has gradually become an important tool for the capital market to identify corporate long-term value, risk exposure and sustainable operating capabilities. Traditional valuation mainly focuses on profitability, return on equity, growth expectations and cost of capital, but these indicators are difficult to fully reflect the differences of enterprises in terms of regulatory pressure, reputational risk, social responsibility and governance structure. Friede et al. summarized a large number of empirical studies and pointed out that there is a non-negative relationship between ESG and corporate financial performance, indicating that ESG is not a simple cost expenditure, but may become an external signal of long-term operating quality [1].

As intermediaries in the capital market, securities firms are characterized by high regulatory oversight, high reputational sensitivity, and strong cyclicality. Their valuations are influenced not only by market conditions, brokerage revenue, investment banking scale, asset management capabilities, and proprietary trading returns, but also by compliance and risk control, client trust, governance transparency, and reputational capital. Once significant compliance penalties, client disputes, investment banking quality issues, or risk management failures occur, the market often rapidly increases the risk discount, leading to downward valuation revisions. Therefore, incorporating ESG principles into securities firm valuation analysis is a practical necessity.

1.2 Research Questions

Existing research largely discusses the relationship between ESG and corporate value from the perspective of general listed companies, but the securities industry has its own unique characteristics. Securities firms themselves have limited direct environmental emissions; if environmental indicators are limited to green office practices, their explanatory power for valuation is weak. Social indicators are closely related to customer protection, wealth management transformation, and financial consumer trust. Governance indicators more directly determine whether securities firms can maintain a balance between business expansion and risk control. Therefore, ESG research on securities firms should not only discuss the overall score, but should further analyze the differentiated mechanisms of the three sub-indicators: E, S, and G.

This article analyzes how ESG sub-indicators affect securities firm valuations, focusing on explaining the pathways through which environmental, social, and governance dimensions enter the valuation logic of securities firms, and proposes optimization strategies based on this analysis.

2. THEORETICAL BASIS

2.1 ESG and Enterprise Value

ESG's influence on corporate value lies in its ability to change investors' judgments on the stability and risk level of a company's future cash flow. Giese et al. pointed out that ESG can enter the capital market pricing process by influencing corporate risk, profitability, and valuation levels [2]. For securities firms, this influence is particularly reflected in risk discounts. Securities firms have complex business structures, and external investors find it difficult to accurately judge their proprietary investment risks, asset management risks, investment banking business quality, and potential compliance costs. Therefore, ESG performance may become an auxiliary signal for the market to judge their long-term stability.

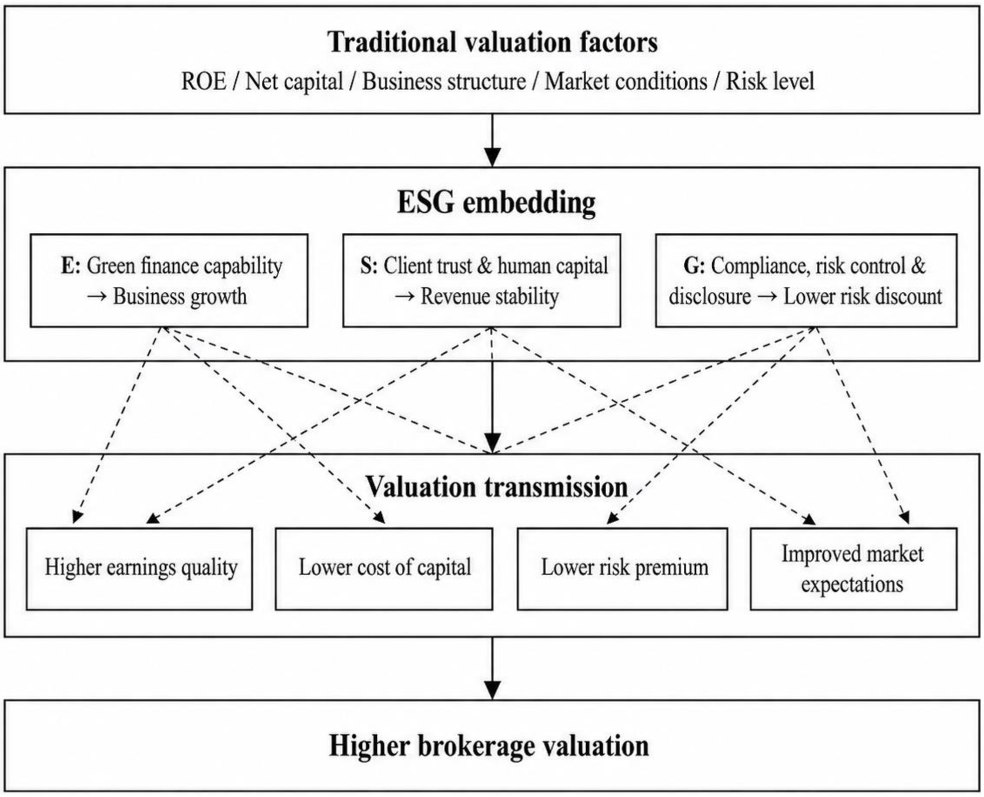

Figure 1. Embedding Relationship between Traditional Valuation Factors and ESG Factors for Securities Firms.

As shown in Figure 1, ESG factors are not independent of the traditional valuation system for securities firms. Rather, they are embedded in core valuation factors such as profitability, capital strength, business structure, market environment, and risk level, further altering the market's judgment of the long-term value of securities firms. Specifically, in the environmental dimension, green finance capabilities expand business growth potential; in the social dimension, customer trust and human capital enhance revenue stability; and in the governance dimension, compliance, risk control, and information disclosure reduce risk discounts. Thus, ESG sub-indicators ultimately affect securities firm valuations through pathways such as earnings quality, cost of capital, risk premium, and market expectations.

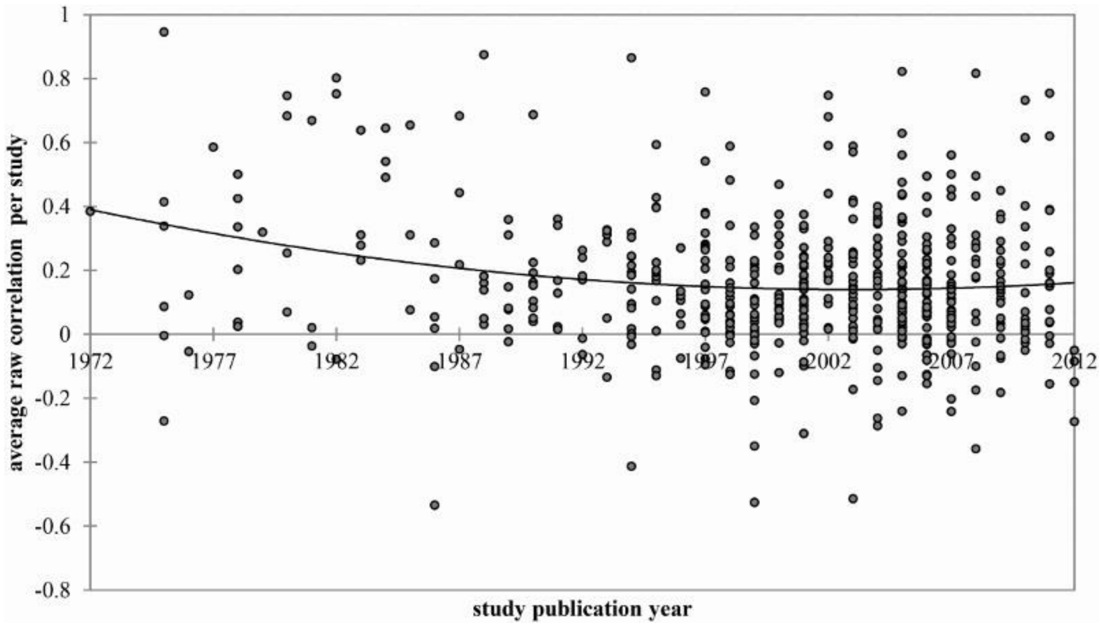

Figure 2. Distribution of empirical evidence on the ESG–financial performance relationship.

Source: Compiled from Friede, Busch, and Bassen (2015).

Existing research indicates a generally non-negative relationship between ESG performance and corporate financial performance (Figure 2), providing an empirical basis for integrating ESG into capital market valuation logic. The average correlation of studies from different years in the figure is mostly distributed in the positive range, suggesting that ESG is not simply an external compliance cost, but may affect long-term corporate value by improving risk control, information transparency, and operational stability. Based on this literature, this paper further breaks down ESG into three dimensions: environmental, social, and governance, analyzing their differentiated effects on securities firm valuation.

2.2 Information Disclosure and Cost of Capital

Information asymmetry is an important channel through which ESG affects valuation. Dhaliwal et al. found that companies' proactive disclosure of high-quality non-financial information helps reduce the cost of equity capital [3]. As financial intermediaries, securities firms' business transparency and the quality of risk disclosure directly affect investor confidence. If the ESG report is only a general description, it is difficult to reduce the uncertainty of external investors; if the disclosure can cover key contents such as compliance penalties, risk management, customer complaints, green finance business and internal control, it is more likely to reduce the valuation discount.

2.3 Governance Structure and Agency Costs

Corporate governance is the dimension of ESG that is closest to the core of valuation for securities firms. Jensen and Meckling pointed out that the separation of ownership and control leads to agency costs [4]. There are also conflicts between business departments and risk control departments, and between short-term performance and long-term stable operation within securities firms. If the governance structure cannot effectively constrain the expansion of high-risk businesses, short-term profits may mask long-term risks. Studies by Gompers et al. have shown that there is an important relationship between corporate governance quality and stock valuation [5]. Therefore, the governance dimension is not only an ESG disclosure content, but also a fundamental constraint on the stability of securities firm valuation.

3. THE MECHANISM BY WHICH ESG SUB-INDICATORS AFFECT SECURITIES FIRM VALUATION

ESG sub-indicators do not directly affect brokerage valuations. Instead, they influence market pricing through intermediary channels such as business growth, risk control, customer trust, and information transparency. The mechanism by which ESG sub-indicators affect brokerage valuations is shown in Figure 3. Specifically, the environmental dimension primarily influences growth expectations through green finance capabilities and environmental risk identification; the social dimension affects revenue stability through customer trust and reputational capital; and the governance dimension reduces risk premiums through compliance and risk control, information disclosure, and incentive constraints. Thus, ESG performance ultimately affects brokerage valuation levels through valuation transmission variables such as capital costs, risk premiums, and profitability stability.

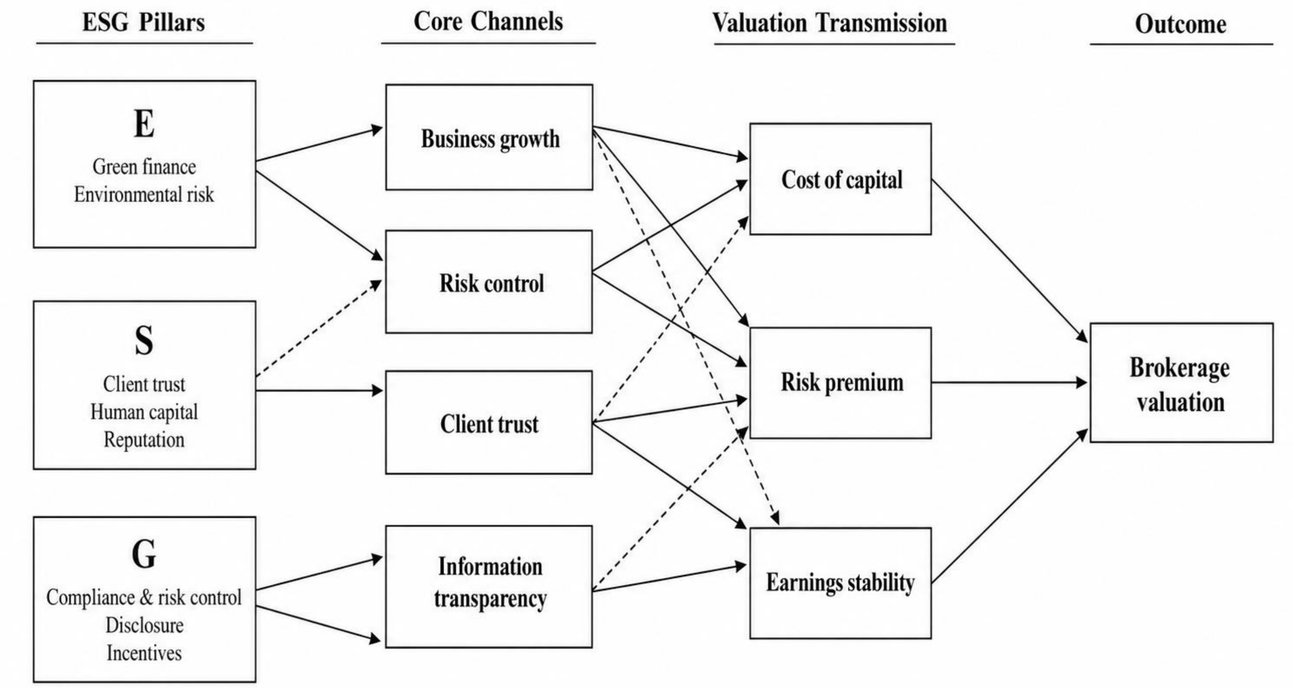

Figure 3. Mechanism framework of ESG pillars affecting brokerage firm valuation.

3.1 Environmental Dimension: From Green Image to Green Finance Capabilities

The impact of environmental factors on securities firm valuations is indirect. Unlike manufacturing and energy sectors, securities firms themselves have lower carbon and pollution emissions. While energy-efficient offices, paperless operations, and green office practices are necessary, they do not constitute the primary source of valuation differences . The truly meaningful aspect of a securities firm's environmental valuation lies in its ability to translate green development requirements into capital market service capabilities.

Specifically, green bond underwriting, green asset securitization, ESG -themed asset management products, green industry research, and transformation financial services are the key to securities firms' entry into the valuation logic of the E dimension. Bolton and Kacperczyk's research shows that the capital market will price carbon risk [6]. This means that if securities firms have the ability to identify corporate environmental risks and low-carbon transformation risks, they can form professional advantages in investment banking due diligence, asset allocation, and risk control.

Therefore, the environmental dimension impacts securities firm valuations primarily through two paths: first, the business growth path, where green finance brings new fee income and institutional client resources; and second, the risk control path, where environmental risk identification reduces potential losses in investment banking, asset management, and proprietary trading. If a securities firm only discloses green office practices and charitable activities without developing green finance capabilities, the actual contribution of the environmental indicator to valuation will be relatively limited.

3.2 Social Dimension: Customer Trust and Reputation Capital

The social dimension has a more direct impact on the valuation of securities firms than the environmental dimension. The securities business is inherently based on trust. Whether customers are willing to open an account, trade, purchase products, or accept investment advisory services depends on their judgment of the professional competence, integrity, and risk control capabilities of the securities firm. Lins et al. found that during the financial crisis, firms with higher social capital showed greater resilience [7]. This conclusion is particularly explanatory for securities firms because the more volatile the market, the more customers rely on their trust judgment of financial institutions.

The core of a brokerage firm's "S" dimension should not be the number of charitable activities, but rather client rights protection, investor suitability management, complaint handling mechanisms, employee professional competence, data security, and investor education. As brokerage firms shift from brokerage-based business to wealth management, the importance of client relationship quality has significantly increased. If brokerage firms can continuously improve their product selection, risk disclosure, and after-sales service capabilities, they can potentially increase client asset retention rates and the stability of wealth management revenue.

Employee capabilities are also an important aspect of the social dimension. Edmans' research shows that intangible assets such as employee satisfaction may reflect value in long-term stock performance [8]. Securities firms are knowledge-intensive industries, and investment banking, research, asset management, derivatives, and compliance risk control all rely on professional talents. Employee training, compliance culture, and career development mechanisms will ultimately translate into business quality and risk control capabilities. Therefore, the S dimension is not a soft indicator, but rather an external manifestation of a securities firm's long-term service capabilities and reputational capital.

3.3 Governance Dimension: The Core Variable for Valuation Discount

Among the three dimensions of E, S, and G, the governance dimension has the most direct impact on the valuation of securities firms. Securities firms' business is characterized by leverage, cyclicality, and strong regulatory attributes. Governance deficiencies often quickly translate into compliance penalties, reputational damage, and capital constraints. Krüger's research found that the market reacts strongly to negative events related to corporate social responsibility [9]. For securities firms, once governance risks are exposed, they are often more likely to trigger a downward revision of valuation than general operational fluctuations.

Securities firm governance primarily impacts valuation through risk control, internal supervision, information disclosure, and incentive mechanisms. Proprietary trading, stock pledging, margin trading, over-the-counter derivatives, asset management, and investment banking all pose potential risks. If a company's governance mechanisms fail to effectively curb its expansionist ambitions, short-term profits may come at the cost of long-term risks. Conversely, securities firms with robust governance structures, clear risk control systems, and effective compliance mechanisms are more likely to receive a lower risk discount from the market.

Information disclosure is also an important channel for governance to influence valuation. Fatemi et al. pointed out that the quality of ESG disclosure will affect the relationship between ESG performance and corporate value [10]. If securities firms can disclose risk management structure, compliance penalty rectification, internal control defects, customer asset security and related transaction management, it will help reduce investors' concerns about potential risks. In contrast, if the disclosure only stays at the name of the system and the principle statement, the governance dimension will hardly play a real role in valuation.

4. OPTIMIZATION STRATEGIES

4.1 Strengthen the orientation of green finance business

Securities firms should shift their focus in environmental development from green office practices to green finance capabilities. Companies should prioritize enhancing their capabilities in green bond underwriting, green asset securitization, ESG-themed product design, green industry research, and transformative financial services. Environmental risk identification should be embedded into investment banking due diligence, asset management investment, and proprietary trading decision-making processes. Only when environmental indicators can generate incremental business and risk control value can the environmental dimension be incorporated into valuation models.

4.2 Reconstructing the Focus of Social Responsibility Evaluation

Brokerage firms' social responsibility should revolve around the long-term value of their clients. Companies should improve their mechanisms for investor suitability management, handling client complaints, investor education services, employee training, and data security. Especially in the context of wealth management transformation, client trust explains a brokerage firm's long-term value more than short-term trading commissions. The focus of the S indicator should not be on public service announcements, but rather on its ability to improve client retention, service quality, and reputation stability.

4.3 Enhance the substantive effectiveness of governance mechanisms

Securities firms' governance optimization should shift from formal compliance to substantive risk control. Companies should strengthen board oversight of risks, prioritize compliance and risk control, implement risk-adjusted performance evaluations, and establish mechanisms for recovering and redeeming compensation to prevent high-risk behavior induced by short-term performance incentives. Governance is not merely decorative content in ESG reports; it is the foundation for securities firms to reduce valuation discounts and maintain trust in the capital market.

4.4 Improve the quality of ESG disclosure

The Shanghai Stock Exchange's guidelines on sustainable development reports have promoted more standardized ESG disclosures by listed companies [11]. Securities firms should reduce vague descriptions and increase quantitative, comparable and verifiable indicators. For example, they can disclose the scale of green finance business in the environmental dimension, the handling of customer complaints and investor education coverage in the social dimension, and the rectification of compliance penalties and internal control deficiencies in the governance dimension. Only when ESG disclosures can explain the revenue structure, risk level and cost of capital will investors include them in their valuation judgments.

5. CONCLUSION

The impact of ESG sub-indicators on brokerage valuations varies significantly. The environmental dimension primarily affects growth expectations through green finance business and environmental risk identification; the social dimension affects revenue stability through customer trust, employee capabilities, data security, and reputational capital; and the governance dimension affects capital costs and valuation discounts through risk control, information disclosure, and incentive constraints. Among these three, the governance dimension is the underlying constraint for valuation stability, the social dimension is an important support for wealth management transformation, and the environmental dimension is the entry point for incremental value in the context of green finance.

ESG development for securities firms should not be limited to improving overall scores and packaging reports, but should return to the essence of the securities industry. As intermediaries in the capital market, the long-term value of securities firms depends on their ability to achieve a stable balance between business growth, risk control, customer protection, and market trust. Only when the E, S, and G sub-indicators are transformed into green finance capabilities, social trust capital, and governance and risk control capabilities, respectively, will ESG truly influence the valuation of securities firms and become an important tool for long-term value management.

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