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The Impact of Managers' Competence on the Relationship between Designation of Respected Firms and ESG Investment

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Abstract. This study examines the relationship between the designation of respected firms and Environmental, Social, and Governance (ESG) investment, while also investigating the impact of managers' competence on this relationship. Using regression analysis on a sample of 738 Korean firms from 2014 to 2021, the findings reveal that firms designated as the most respected in the market tend to make more ESG investments. Additionally, the most respected firms with highly competent managers are more likely to invest in ESG. These results suggest that the designation as a respected firm serves as an intangible asset that positively affects firm value. This research provides empirical evidence on the connection between the most respected firm designation and ESG investment, offering academic and practical insights into how ESG investment contributes to a company's sustainability.

Keywords: Competent managers, ESG, Respected firms.

1. INTRODUCTION

According to the Korea Management Association Consulting (KMAC), a respected firm is defined as a company that generates outstanding managerial performance based on superior competitiveness cultivated through continuous innovation activities. These firms actively engage in socially responsible activities and receive favorable evaluations from all stakeholders. To be recognized as a respected firm, a company must demonstrate excellence in intangible assets, including innovation capability, and values of shareholder, employee, customer, social, and brand image, which result in firms' sustainability (Kim and Kim, 2020).

Designation as the most respected firms is the global trend. For example, Fortune magazine in the United States, Financial Time in the United Kingdom, and Nikkei Business in Japan announce the most respected firms annually. Also, in South Korea, KMAC has been selecting and announcing the most respected companies since 2004. Designated as the most respected firms are non-financial intangible assets which comprise almost 70% of firms' total assets (Capraro and Srivastava, 1997), and one of the vital elements in deciding firm performance (Aaker & Jacobson 2001). Non-financial information reflects a company's willingness to provide evidence of its business practices and the integration of sustainability into strategic and decision-making processes, which are critical for achieving sustainable goals (Jackson et al., 2020; Hess, 2019; Rezaee & Tuo, 2017) and to predict a firm's financial performance (Serafeim & Grewel, 2017).

Therefore, being designated as a respected firm goes beyond enhancing a company's reputation; it serves as a critical indicator of the firm's sustainability and commitment to social responsibility (Feng et al. 2022). In this context, ESG investment is closely related to the designation of respected firms. ESG investment evaluates a company's efforts to fulfill environmental responsibilities, create social value, and maintain transparent and ethical governance structures, which align with the core criteria for being recognized as a respected firm (Xperts Council, 2023). ESG investment has emerged as a key metric for assessing a company's non-financial performance, contributing to its long-term sustainability and building trust among stakeholders (Yoon, 2023). Companies designated as respected firms are more likely to integrate ESG factors into their business strategies, thereby receiving favorable evaluations from investors, consumers, and society at large. Moreover, ESG investment not only enhances the value of a company's intangible assets but also demonstrates a positive correlation with financial performance, as evidenced by prior research (Serafeim & Grewel, 2017).

This study aims to empirically analyze the impact of being designated as a respected firm on ESG investment. By doing so, it seeks to explore how ESG investment contributes to strengthening a company's sustainability and social responsibility, as well as its long-term performance and reputation. The findings of this study are expected to provide significant academic and practical insights into the interplay between ESG investment and the designation of respected firms.

Also, this study investigates the influence of being recognized as the most respected company on ESG investment, focusing on the role of managerial ability. According to the Upper Echelons Theory (Hambrick and Mason, 1984), managerial characteristics significantly shape corporate strategies and decision-making processes. Managers with high levels of ability are more likely to allocate resources efficiently and prioritize long-term value creation, thereby actively engaging in ESG investments (Yuan et al., 2017; Demerjian et al., 2012). Such managers are adept at managing uncertainty and complexity, aligning ESG strategies with corporate objectives to enhance organizational sustainability (Bonsall et al., 2017). Accordingly, this study empirically examines the

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moderating effect of managerial ability on the relationship between being a most respected company and ESG investment.

The regression analysis reveals that firms designated as the most admired companies tend to engage in higher levels of ESG investment. Furthermore, managerial competence significantly strengthens this relationship. Specifically, highly capable managers play a pivotal role in the strategic decision-making process related to ESG investments, contributing to enhanced corporate sustainability and long-term value creation. These findings underscore the critical role of managerial ability in driving corporate social responsibility and improving ESG performance.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

The growing global interest in sustainability has led to a significant shift in corporate evaluation and recognition practices. The selection of respected firms has emerged as a prominent global management trend, extending its influence across both developed and emerging economies. For instance, in the United States, Fortune has been selecting and announcing, The World's Most Admired Companies since 1994. Similarly, other countries have adopted comparable practices, such as 'The World's Largest Companies by the Financial Times in the United Kingdom since 1982, Australia's Most Respected Companies in Australia, and Japan's Most Admired Companies in Japan. These initiatives reflect the increasing emphasis on sustainability and corporate reputation in the global business landscape.

In Korea, KMAC announces the "Most Admired Companies in Korea." This recognition is based on a survey-driven evaluation that comprehensively assesses companies across six key values, including continuous technological innovation, customer value, shareholder value, employee value, and brand image, through an integrated research process. The companies recognized as the most respected are anticipated to demonstrate exceptional performance in their respective markets. Furthermore, these companies are expected to faithfully fulfill their social responsibilities and receive positive evaluations from all stakeholders (Cho et al., 2010). According to KMAC Consulting, being recognized as the most respected companies signify more than merely achieving profitability; it reflects the ability to deliver outstanding business outcomes through continuous technological innovation and sustainable competitiveness.

For the firms' sustainability, it is necessary to develop technological capabilities, build value for shareholders and employees, and gain customer trust (Kang et al., 2022). These factors contribute to the intangible elements of financial assets, which constitute the majority of financial assets, while only 30% of financial assets are considered when evaluating corporate value.

Non-financial information is considered trustworthy because it is derived from independent sources, making it less vulnerable to fraudulent accounting practices or profitability manipulation compared to financial information Brazel et al. (2009). Gamerschlag (2013) and Bianchi et al. (2014) align with the idea that non-financial information provides value-relevant information and crucial for the firms' growth and performance. In this context, non-financial information serves as a supplementary source of insight for markets and shareholders, extending beyond traditional financial metrics and ultimately contributing to the long-term sustainability of corporations.

ESG investments have increased 34% in 2019 compared to 2016 (Park and Han, 2021). This shift reflects a transformation in corporate goal, moving away from the traditional focus on maximizing shareholder profits and net income, toward prioritizing Environmental, Social, and Governance (ESG) considerations (Jeon, 2022). Moreover, as ESG evaluation criteria emphasize the interests of various stakeholders, including employees, shareholders, and society (Park and Han, 2021), companies that engage in ESG investments inherently align with fostering trust and respect, which serve as fundamental pillars for sustainable growth and long-term viability. According to Jeon (2022), ESG investments emphasize environmental responsibility, social contribution, and transparent and ethical governance structures, which align with the core values already practiced by respected companies. Therefore, respected companies are more likely to actively engage in ESG investments within this context.

With this reasoning, the first hypothesis is developed as follows.

Hypothesis 1. *The firms designated as the most respected are likely to make ESG investments.*

The upper echelons theory (Hambrick and Mason, 1984), managers' characteristics based on their cognitive structures, values and beliefs, influence corporate strategy. Prior research in the field of accounting related to this theory indicates that managerial characteristics exert a distinctive influence on a firm's accounting decisions. With the increasing demand for greater transparency in accounting and management, the role of managers has become increasingly emphasized as the core of the financial decision-making process (Bamber et al., 2010).

This study focuses on managerial competence. Competent managers are anticipated to possess a deeper understanding of the customer base and macroeconomic conditions (Plumlee and Yohn, 2010). They utilize corporate resources efficiently (Demerjian et al., 2012) and are more likely to invest in projects with higher net present value (NPV) compared to managers with lower abilities (Chemanur and Paeglis, 2005). Furthermore, highly competent managers increase investment in uncertain future opportunities, leading to higher profitability, reduced information asymmetry, and increased debt, which ultimately enhances firm performance (Andreou et al.,

2013). Thus, managerial competence is emphasized as having a significant impact on corporate investment decisions, resource utilization, and performance improvement.

Managers' competence affects corporate's social activities. Yuan et al. (2017) and Ban and Jeong (2017) assert that the level of corporate social responsibility (CSR) is affected by the degree of managers' abilities. Also, competent managers are willing to make long-term investments in socially beneficial activities, thereby improving CSR performance (Yuan et al., 2017). In addition, managers serve as key drivers in the effective implementation of social, environmental, and economic initiatives (Bolivar et al., 2012).

Building upon this foundation, this study proposes that companies designated as the most respected firms with highly competent managers are expected to invest more in ESG initiatives, since both attributes share similar fundamental characteristics. The competent managers who lead these organizations are well positioned to recognize the long-term value of ESG investments, since their deeper understanding of market dynamics and stakeholder expectations (Plumlee and Yohn, 2010) enables them to align ESG strategies with overall business objectives effectively. Furthermore, as competent managers are more adept at handling uncertainty and complexity (Bonsall et al., 2017; Ban and Jeong, 2017), they are better equipped to navigate the challenges associated with ESG implementation. They can more accurately assess the potential risks and rewards of ESG investments, leading to more strategic and impactful initiatives. With reasoning, this study aims to empirically examine the impact of managers' competence on the relationship between the designation of the most respected firms and ESG investment. The second hypothesis is established as follows.

Hypothesis 2: Highly competent managers are likely to impact the relationship between the designation of the most respected firms and ESG investments.

3. METHODOLOGY

3.1. Data Collection Process

To maintain sample homogeneity, this study includes companies in the non-financial industry from 2016 to 2021. Firms with fiscal year-ends other than December were excluded from the analysis. The sample was further restricted to companies for which data on the designation of respected firms and ESG scores. The information on the designation of respected firms is obtained from KMAC consulting firms and ESG scores are from KCGS. Financial data utilized in this study were obtained from the Fn-Guide database. This selection process was designed to reduce the risk of distorted financial information, thereby enhancing the reliability and accuracy of the data analyzed. As a result, the final sample comprises 738 company-years.

3.2. Research Model

The following regression models are employed to analyze the influence of being designated as a respected firm on future ESG investments. Model (1) is designed to test this impact, addressing the first hypothesis, while the second model evaluates the role of managerial ability in respected firms on future ESG investments.

$$ESGinv_{t+1} = \beta_0 + \beta_1 Respect_t + \beta_2 Size_t + \beta_3 Lev_t + \beta_4 Roa_t + \beta_5 Ocf_t + \beta_6 Invrec_t + \beta_7 Da_t + \beta_8 Loss_t + \beta_9 Grow_t + IndD + YrD + \varepsilon \quad (1)$$

Where, ESGinv = ESG investment in period of t+1; Respect = score of respected firms; Size = natural logarithm of total assets; Lev = total debt divided by total assets; Roa = net income/total assets; Ocf = cash flow from operation/total assets; Invrec = ratio of accounts receivables; Da = Discretionary accruals measured by the model in Kothari et al. (2005); Loss = 1 if a company with loss, and 0 otherwise; Grow = (total assets in the current year – total assets in the previous year)/total assets in the current year ; IndD = industry dummies; YrD = year dummies

To apply this approach, we employ ESG scores provided by the Korea Institute of Corporate Governance and Sustainability (KCGS). Building on prior research, firm size (Size) and financial leverage (Lev) are incorporated into the model to mitigate potential biases. To account for firm performance and risk, Roa and Loss are included as respective measures. The calculation of Da is based on the discretionary accruals as suggested by Kothari et al. (2005), as described in equation (2).

$$\frac{Ta_t}{A_t} = \alpha_0 + \beta_1 \frac{1}{A_t} + \beta_2 \left(\frac{\Delta Sales_t - \Delta Ar_t}{\Delta Ar_t} \right) + \beta_3 \frac{Ppe_t}{A_t} + \beta_2 Roa_t + \varepsilon \ (2)$$

Where, Ta = Net income – cash flow from operations; A = Total assets; Sales = Sales revenue; Ar = Accounts receivable; Ppe = Plant, property, and equipment; Roa = Return on assets, Net income / total assets

Additionally, year dummies are introduced to control volatility stemming from specific economic conditions within a given year. To address industry-specific effects, the model also incorporates industry dummies.

The equation (3) tests the second hypothesis. MA represents managers' competence. The variable RM is the interaction term between the designation of the most respected firms and managers' competence.

$$ESGinv_{t+1} = \beta_0 + \beta_1 Respect_t + \beta_2 MA_t + \beta_3 RM_t + \beta_4 Size_t + \beta_5 Lev_t + \beta_6 Roa_t + \beta_7 Ocf_t + \beta_8 Invrec_t + \beta_9 Da_t + \beta_{10} Loss_t + \beta_{11} Grow_t + IndD + YrD + \varepsilon \quad (3)$$

Where, MA = managers' competence, suggested by Demerjian et al. (2012); RM = interaction term between designation of the most respected firms and managers' competence ($Respect \times Managers\ ability$)

The variable definitions are described in equation (1). MA is measured by the method suggested by Demerjian et al. (2012). Demerjian et al. (2012) propose that managerial competence can be assessed by evaluating a firm's efficiency in transforming resources into revenue, relative to its industry peers. The methodology involves evaluating a firm's efficiency by analyzing the relationship between resource inputs and outputs through Data Envelopment Analysis (DEA). Key resource inputs include the cost of goods sold (COGS), selling, general, and administrative expenses (SG&A), tangible assets (PPE), and intangible assets (Intan), all of which play a critical role in profit generation. The output is represented by the firm's sales. The firms' relative efficiencies can be represented using DEA shown in the following equation.

$$Max_v \theta = \frac{Sales}{v_1 Cogs + v_2 Sga + v_3 Ppe + v_4 Intan} \quad (4)$$

where, Sales = Firm's sales; Cogs = Cost of goods sold; Sga = Selling, general, and administrative expenses; Ppe = Property, plant, and equipment; Intan = Intangible assets

The optimization process determines the firm-specific optimal weight vector, denoted as *v*, for the four inputs by comparing the inputs chosen by each firm to those selected by other firms within the estimated group to which the firm belongs. In accordance with the constraints of the optimization, DEA produces an efficiency measure, θ, which takes a value between 0 and 1. The most efficient observations are assigned a value of 1, indicating that firms with an efficiency score of 1 operate on the frontier, representing the most efficient set of possible input combinations. Observations with efficiency scores below 1 are considered to fall below the frontier. The DEA score reflects the extent to which an organization can maximize its profits. A firm with a score below 1 would need to either increase its revenue or reduce its costs to improve its efficiency.

The efficiency measure derived from the DEA estimation is associated with both the firm and its manager. For instance, a more capable manager is better equipped to anticipate trends, regardless of the firm's size. Similarly, highly skilled managers in larger firms are more effective in negotiating with suppliers. To refine the DEA-based firm efficiency measure, Demerjian et al. (2012) exclude key firm-specific variables that are expected to either facilitate or hinder managerial efforts. This adjustment enhances the accuracy of the DEA-generated efficiency measure. Variables that support management, such as firm size, market share, positive free cash flow, and firm age, as well as variables that pose challenges, such as multi-segment operations and international activities, are incorporated. Finally, a Tobit regression model is estimated by industry.

$$Effi = \alpha_0 + \alpha_1 Ast + \alpha_2 St + \alpha_3 FcfD + \alpha_4 Age + \alpha_5 Bz + \alpha_6 Fs + Yr + \varepsilon \quad (5)$$

Where, Effi = firm efficiency; Ast = ln(total assets); St= Sales/Total revenue of firms in the industry; FcfD = 1, if free cash flow is greater than 0, 0 otherwise; Age = ln(firm year after listing); Bz = ln(number of business segment) ; Fs = (foreign currency translation gain and loss + profit and loss on exchange)/sales; Yr = year; ε = residual, representing managers' competence

A two-step analytical approach is employed to evaluate managerial skill as an independent variable using Data Envelopment Analysis (DEA). In the first step, DEA is utilized to construct an efficient frontier, which accounts for the resources utilized by firms within the same industry to generate revenue. Firms positioned on the efficient frontier receive an efficiency score of 1, while scores decrease as firms deviate further from the frontier.

In large firms, even managers with average or below-average abilities may secure more favorable terms with manufacturers compared to highly skilled managers in small and medium-sized firms. To address this, Tobit regression is applied, excluding firm-specific factors that are likely to either support or hinder managerial performance from the total efficiency measurement. In essence, managerial efficiency is defined as the residual efficiency that remains unexplained after accounting for these external factors. The relative efficiency of firms within each industry is thus determined through this process.

3.3. Sample Selection

Table 1 describes the procedures to get the final sample to test the hypotheses. We manually collected firm data of customer satisfaction and admired firms from KMAC consulting. We acquired ESG data from Korea Corporate Governance Service (KCGS). We use the FnGuide database for financial data as control variables.

We include all the firms listed in the Korea Stock Exchange with December year-end from 2014 to 2018. We eliminated the firms in the financial industry. Firms without or incomplete financial data are removed. The top and bottom 1% of dependent and independent variables are winsorized to minimize the outlier effect. After the selection process, we get the final 738 firm-year observations.

Table 1: The data description.

Firm-year observations from 2014 to 2021 with information on the most respected firms, ESG, and managerial ability for companies with December fiscal year-end	**1,542**
Less:	
Missing data for control variables	804
Final observation	738

4. RESULTS
4.1. Descriptive Statistics and Correlation Matrix

Table 2 displays the description statistics for the main variables. The mean of admired and satisfaction are 0.092 and 0.072, respectively. The average value of ESG is 3.309 and median value is 3.296.

Table 2: Descriptive statistics.

Variables	Mean	Std	Q1	Median	Q3
ESGinv	2.460	1.216	1.253	2.996	3.434
Respect	1.863	0.110	1.798	1.870	1.939
MA	0.000	0.251	-0.179	-0.012	0.154

Note: Variable definition:

Table 3 shows the Pearson correlation matrix for this study's main variables. We can confirm that satisfied customers and being selected as admired firms are positively related. The result indicates that customer satisfaction and ESG are useful in explaining admired firms.

Table 3: A Correlation matrix.

	(1)	(2)	(3)
(1) ESGinv	1.000	0.096	-0.011
		0.001	0.366
(2) Respect		1.000	-0.016
			0.631
(3) MA			1.000

4.2. Regression Analysis

Table 4 shows the result of regression analysis on the relationship between designation of the most respected firms and ESG investments. The coefficient of the variable, Respect, shows 0.576, positively significant at 1% level. This finding suggests that the firms that are designated as the most respected firms are likely to make ESG investments. This finding aligns with previous research suggesting that respected companies focus more on sustainability, technological innovation, and stakeholder value creation, and demonstrates that the recognition of ESG investments' importance for long-term sustainability and reputation translates into actual investment behavior.

Table 4: The regression results on the relationship between designation of respected firms and ESG investments.

Variables	Coeff.	t-stat.
Intercept	-1.189	-4.460***
Respect	0.576	5.750***
Size	0.123	15.300***
Lev	0.002	0.750
Roa	-0.069	-0.250
Ocf	0.295	1.310
Invrec	0.012	0.160
Da	-0.103	-0.520
Loss	-0.037	-0.950
Grow	-0.058	-2.330**
IndD	Included	
YrD	Included	
F-value	550.11***	
Adj. R^2	0.945	
Observations	738	

Note: 1) ** and *** indicate significance at the 5% and 1% levels, respectively. 2) See equation (1) for variable definition.

Table 5 shows the result of examining the second hypothesis using equation (3), assessing the impact of managers' competence on the relationship between the most respected firms and ESG investments. RM is the interaction term between managers' competence and the most respected firms. The coefficient of RM is 0.002,

statistically significant at 1% level, which suggests that managerial competence strengthens such relationships. The results indicate that firms designated as the most respected, when led by highly competent managers, exhibit a stronger relationship with ESG investments. The positive and significant coefficient of RM demonstrates that managerial competence enhances the firm's commitment to ESG initiatives. This suggests that competent managers, with their ability to allocate resources effectively and assess the potential risks and rewards of ESG investments, enable them to drive impactful and sustainable initiatives. This aligns with prior research emphasizing the role of managerial competence in influencing corporate social responsibility and sustainability practices (Yuan et al., 2017; Ban and Jeong, 2017).

Table 5: The effect of managers' competence on the relationship between designation of respected firms and ESG investments.

Variables	Coeff.	t-stat.
Intercept	-1.189	-3.770***
Respect	0.576	4.310***
MA	0.123	-1.550
RM	0.002	2.950***
Size	-0.069	14.040
Lev	0.295	0.950
Roa	0.012	0.170
Ocf	-0.103	-0.130
Invrec	-0.037	-0.900
Da	-0.058	-0.300
Loss	-1.189	-0.810
Grow	0.576	-1.010
IndD	Included	
YrD	Included	
F-value	425.27***	
Adj. R^2	0.946	
Observations	738	

Note: 1) *** indicate significance at the 1% level. 2) See equation (1) and (3) for definitions of variables.

5. CONCLUSION

The present study empirically examines whether designation as the most respected company can lead to superior investment performance. This study analyzed companies recognized as 'All-Star Companies Most Respected in Korea,' announced by KMAC from 2014 to 2021, and confirmed that these respected companies actively engage in ESG investments. This study further seeks to examine the mediating effect of managers' competence on the relationship between respected firms and ESG investments, thereby exploring the role of managers' competence as a decision maker within the firm.

ESG management for creating economic and social value for companies contains information on non-financial factors that reflect the unique characteristics of the company and the industry. Managing these non-financial factors and linking them with long-term strategies to generate sustainable profits can help build trust with stakeholders. Also, highly competent managers positively influence corporate value by investing from a long-term perspective. Designation of the company as a respected company, combined with managers' competence attracts ESG investments.

This study contributes to the extant literature. This study demonstrates that firms designated as respected companies are more likely to actively engage in ESG investments, which, in turn, contribute to long-term value creation. This provides investors with a critical framework for evaluating non-financial information related to ESG investments. Additionally, the finding that managerial competence strengthens the relationship between ESG investment and corporate value suggests that investors should consider managerial capabilities as a key factor in their evaluations. Thus, this study underscores the importance of non-financial information related to ESG investments in building trust in the market and guiding investment decisions.

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