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Domestic vs. Foreign Institutional Investors: Who Improves ESG and Value of Chinese Companies?

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Abstract: Recent years have seen the influence of both institutional investors and corporate social responsibility strengthen in the Chinese capital market. However, research on the impact of these market changes on corporate activities and values has been insufficient. To address this gap, this study analyzes the impact of foreign and domestic institutional investors who invest in Chinese A-share listed companies on corporate value through environmental, social, and governance (ESG) policies. The results of the analysis are as follows: First, the shareholding of both foreign institutional investors (FIIs) and domestic institutional investors (DIIs) enhances corporate value. Second, the shareholding of FIIs strengthens the company's ESG, while that of DIIs does not significantly affect it. Third, ESG has a positive impact on corporate value. Fourth, ESG partially mediates the positive relationship between the shareholding of FIIs and corporate value. The research findings provide academic implications for the causal relationship between corporate governance, sustainable management, and performance, as well as practical implications for the development of the Chinese capital market and corporate sustainability.

Keywords: institutional investor; foreign institutional investor; domestic institutional investor; environmental; social; and governance; corporate value

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1. Introduction

Unlike advanced capital markets, where institutional investors account for over 90% of market capitalization, China's stock market has a high proportion of individual investors, which may hinder the efficient procurement and utilization of resources. Therefore, to promote the development of the capital market and enhance global competitiveness, the Chinese government introduced the "Accelerated Development of Institutional Investors" strategy in 2000, and the China Securities Regulatory Commission (CSRC) designated the "Continuous Development of Institutional Investors" as the main development strategy for China's capital market from 2008 to 2020 [1]. Consequently, China's financial industry has developed rapidly in recent years. From 2011 to late December 2019, the proportion of corporate shares held by institutional investors increased from approximately 20% to 40% [2].

In addition, the intensification of environmental pollution and social conflicts has led to heightened interest in the social and environmental impact of economic activities in China. In September 2020, President Xi Jinping announced that China would achieve carbon neutrality by 2060. Furthermore, with the rapid spread of the concepts of green finance and responsible investment, the CSRC has tightened the regulations on ESG information disclosure by listed companies to realize green development and emphasize the importance of social responsibility [3]. Consequently, the number of sustainability reports published in the Chinese A-share market increased from 371 in 2009 to 942 in 2019, and the impact of institutional investors on ESG activities and performance has become a vital concern both for researchers and practitioners.

As the role of institutional investors in promoting ESG practices gains prominence, it becomes crucial to recognize the diversity within this investor group. Institutional investors are not a homogeneous entity; they can be broadly categorized into foreign institutional investors (FIIs) and domestic institutional investors (DIIs). This distinction is particularly relevant in the context of China's evolving capital market, as FIIs and DIIs may have different investment philosophies, risk appetites, and levels of familiarity with local market conditions.

FIIs often bring global perspectives and practices to their investment strategies, shaped by their experiences in more mature markets with established ESG frameworks. Their global exposure and adherence to international ESG standards might lead them to prioritize sustainability and governance policies and pursue them more rigorously [4]. This can have a significant impact on the ESG performance of Chinese companies, as FIIs may exert pressure on firms to align with global best practices. On the other hand, DIIs are likely to have a deeper understanding of local market dynamics, regulatory environments, and cultural nuances [5]. However, their impact on ESG practices may be less pronounced. DIIs may be less likely than FIIs to put pressure on the companies in which they have invested to act in a socially responsible manner because of their potential lack of understanding and experience in ESG matters. Additionally, given the relatively immature institutional environment of the Chinese stock market, DIIs may have significant connections to, and be in potential collusion with, insiders of listed companies. This difference in approach and local market embeddedness suggests that DIIs in China might not have as significant a positive impact on a company's ESG performance as their foreign counterparts.

Despite the rapid development of China's capital market and the growing interest in ESG practices, a significant gap remains in our understanding of how institutional investors affect the ESG performance and corporate value of Chinese companies [6–8]. This knowledge gap is particularly pronounced when considering the potential differential effects of FIIs and DIIs. Prior studies have largely treated institutional investors as a homogeneous group, overlooking the nuanced differences between FIIs and DIIs. However, these two groups often have distinct characteristics, investment philosophies, and levels of familiarity with both global ESG standards and local market conditions. These differences could lead to varying impacts on the ESG practices and overall value of the companies in which they invest. Furthermore, while some studies have examined the role of institutional investors in developed markets, the unique characteristics of China's evolving capital market necessitates specific research in this context. The relatively recent opening of China's market to foreign investors, coupled with the country's distinct regulatory environment and cultural norms, creates a unique setting that may not align with findings from other markets. This study is intended to address these research gaps by providing a comprehensive analysis of how FIIs and DIIs influence the ESG performance and corporate value of Chinese-listed companies. By distinguishing between these two types of institutional investors, we seek to uncover potential differences in their impact and the mechanisms through which they influence corporate behavior and value.

The study's results have academic implications for the importance of research focusing on the causal relationship between corporate governance, sustainable management, and performance, and provide motivation for conducting convergence research in these fields. They also have practical implications for the role of foreign investors and governments in improving capital markets and strengthening corporate sustainability.

2. Theoretical Background

2.1. Introduction to Institutional Investors

Institutional investors are organizations that invest their own resources or funds raised to generate returns. They take on risks to maximize profits within a set timeframe [9]. They evaluate financial and non-financial information about a company's performance, strategy, and governance procedures in their investment decision-making process [10].

The emergence of professional institutional investors in China can be traced back to the 1990s when the first closed-end funds were established. However, during the early development of the securities investment fund industry, the market environment was incomplete, relevant laws and regulations were unclear, the quality of fund assets was low, and an effective information disclosure system was absent. Consequently, investors' returns were not satisfactory until the "Interim Measures for the Administration of Securities Investment Funds" was implemented in November 1997, marking a new development phase. Since 1999, three types of corporate funds, as well as insurance companies' funds, have been conditionally allowed to enter the stock market. Furthermore, in 2006, the CSRC adopted a series of plans to provide a more liberal growth environment and an improved market for the fund industry, allowing institutional investors to play an increasingly vital role in the capital market. In 2007, the restrictions on insurance companies' stock market investments were further relaxed, leading to a continuous expansion of their investment scale and a significant change in their investment asset structure.

According to the RESSET database, which provides information on institutional investors in Chinese companies, institutional investors comprise securities companies, insurance companies, trust companies, financial companies, securities investment funds, social security funds, qualified foreign institutional investors (QFIIs), banks, and non-financial listed companies. The term "QFIIs" refers to "overseas fund management institutions, insurance companies, securities companies, and other asset management institutions approved by the CSRC to invest in the Chinese securities market and [that] have been allocated an investment quota" [11]. The QFII program, jointly managed by the CSRC and the State Administration of Foreign Exchange (SAFE), was introduced in November 2002 to allow FIIs to invest in China.

In 2006, the CSRC, the People's Bank of China, and SAFE jointly issued the "Measures for the Administration of Domestic Securities Investments by Qualified Foreign Institutional Investors" to replace the 2002 QFII measures. This new regulation was intended to attract long-term foreign investment while limiting excessive risks and short-term speculative capital inflows [12]. The regulation defines QFIIs as foreign fund management institutions, insurance companies, securities firms, or other asset management institutions. It requires them to obtain investment approval from the CSRC and an investment quota from SAFE.

Since 2006, the QFII program has significantly expanded in terms of scale and scope [12]. By August 2006, SAFE had approved a total QFII investment quota of $7.495 billion, accounting for three-quarters of the then-total limit of $10 billion. By the end of 2007, the Chinese government had increased the QFII investment quota from $10 billion to $30 billion. The initial limit of $4 billion in November 2002 was later raised to $300 billion in January 2019. From 2010 to 2020, the number of companies held by QFIIs in the Chinese A-share market has shown an overall increasing trend, with a significant increase in 2020. Compared to 2019, the number of companies increased by 131, a 63.3% increase; compared to 2010, their number increased by 214, a 172.6% increase [13].

2.2. ESG (Environmental, Social, and Governance)

The concept of ESG focuses on a company's environmental management, social responsibility, and governance, and it is essential for the sustainable development of a company. Investors consider ESG comprehensively in their investment decision-making process. They measure ESG and evaluate its impact on a company's operations to predict investment risks and returns and select investment targets [14]. For instance, in recent years, green finance and responsible investment have rapidly developed in China. The CSRC has improved listed companies' ESG information disclosure rules to promote green development and fulfill social responsibility requirements. Therefore, the number of sustainability reports published in the Chinese A-share market increased from 371 in 2009 to 942 in 2019. ESG has attracted substantial interest from institutional investors since the Chinese A-share market has been included in the MSCI index.

The arguments on the impact of ESG on corporate management and performance comprise both a negative view, based on the agency theory perspectives, and a positive view, which accounts for the stakeholder perspective [15]. The most crucial logical basis for the negative impact of ESG on financial performance is that the management—the agent of the shareholders—may use resources to maximize shareholder interests for personal or social reasons rather than financial considerations, compromising shareholder interests [16]. Therefore, from the agency theory perspective, ESG can be considered a cost that should be minimized, as decision-making based on environmental or social responsibility can lead to opportunity costs and decrease financial performance [17–19]. Building on these theoretical foundations, empirical studies have uncovered additional concerns regarding ESG activities. Excessive ESG activities can cause companies to allocate their resources inefficiently. More worrisome is that some companies attempt to conceal financial irregularities by exploiting ESG activities. Li et al. (2024) [20] found that some Chinese listed companies tried to hide goodwill impairment through charitable donations, suggesting that ESG activities may actually hinder the evaluation of a company's financial soundness.

In contrast, scholars arguing for the positive effects of ESG base their claims on the stakeholder perspective. Freeman (1984) defines stakeholders as all individuals and groups, including shareholders, management, customers, suppliers, creditors, local communities, competitors, governments, and non-governmental organizations, that affect or are affected by the company [21]. Freeman emphasizes the necessity of strategic responses that consider the interests of various stakeholders for a company to achieve and strengthen sustainability. Many studies based on stakeholder theory argue that stakeholders can directly or indirectly influence a company's activities and performance. While shareholder-centric management makes achieving sustainability difficult, respecting various stakeholders' interests improves a company's competitiveness and value.

3. Hypothesis Development

3.1. Relationship between Institutional Investors and Corporate Value

Pound (1988) proposes three hypotheses regarding the role of institutional investors in corporate governance: the effective monitoring hypothesis, conflict of interest hypothesis, and strategic alliance hypothesis [22]. The effective monitoring hypothesis suggests that institutional investors can monitor management and contribute to performance improvement. The conflict of interest hypothesis contends that institutional investors may have difficulties monitoring managerial opportunism because of their business relationships with the firm. The strategic alliance hypothesis posits that the mutually beneficial relationship between institutional investors and management can weaken the monitoring role of institutional investors.

On the basis of these three hypotheses, scholars have reached two contrasting views. Studies grounded in the conflict of interest and strategic alliance hypotheses suggest that institutional investors may support management, exploit minority shareholders, and impair firm performance. They argue that institutional investors are only interested in speculative short-term trading profits based on information advantages [23], may overlook managerial misconduct if they can profit from it, and may fail to play the role of supervisors in improving corporate governance and performance [24]. By contrast, studies based on the effective monitoring hypothesis suggest that institutional investors can improve a firm's decision-making and performance. They argue that institutional investors with large shareholdings have strong incentives to monitor the firm's performance and management's behavior, and their monitoring can help resolve information asymmetry and agency problems [25]. In addition to advising management, institutional investors can influence management through excellent management skills, expertise, and voting rights, hence improving the firm's efficiency and performance [26,27].

According to agency theory, institutional investors can practice "shareholder activism" to ensure that management and directors adopt a corporate management approach that aligns with the interests of shareholders [28]. They can participate in corporate manage-

ment and take active measures to improve management through methods such as voting rights, proxy solicitation [29], shareholder proposal announcements, private negotiations with management [30], and hostile takeovers and mergers [31,32]. However, institutional investors may be heterogeneous, and different investors may exhibit differential investment tendencies and roles. Therefore, this study examines the impact on the corporate value of DIIs and FIIs who invest in Chinese listed companies.

Some scholars argue that it is difficult for FIIs to actively participate in the management activities of the investee company due to their limited understanding of the investment host country [33] and that because of their low levels of localization and low investment ratios, FIIs lack the motivation to affect the strategies of their investee companies, and their superior investment returns are attributable to their stock selection ability [34,35]. However, given the rapid increase in foreign institutional investment among Chinese companies, these constraints do not appear to have been a major factor in FIIs withdrawing their investment. Instead, anticipating the high growth potential of the Chinese economy, FIIs have invested more actively and increasingly played the role of monitors of corporate management.

According to the internal power perspective of corporate governance research, FIIs can mitigate the principal-agent problem between controlling and minority shareholders. FIIs with high shareholdings have the ability and incentive to monitor the controlling shareholders' expropriation and protect the interests of investors [36]. The increase in foreign institutional investment can play a vital role in suppressing the monopoly of controlling shareholders and improving performance [37].

FIIs, such as QFIIs, foreign funds, foreign asset management companies, and joint venture funds, are relatively mature and rational investors that follow the "value investment" philosophy and aim for long-term investment returns [4]. Therefore, they tend to adopt a long-term holding strategy for the stocks of listed companies and seek to obtain sustainable investment returns by improving corporate value [38]. They also contribute to increasing firm value by reducing agency costs, improving corporate transparency, enhancing accounting earnings quality, and improving governance structure. Their independence from local companies allows them to be more actively involved in corporate management [39]. Therefore, the following hypothesis is proposed:

H1-1. *FIIs have a positive impact on corporate value.*

DIIs tend to be less active than FIIs in monitoring their investee companies. DIIs often have business relationships with investee companies [39,40]. In this regard, Ferreira and Matos (2008) [40] analyze companies from 27 countries from 2000 to 2005 and show that FIIs and independent institutional investors improve firm value measured by Tobin's Q, operating performance measured by return on assets (ROA), and net profit margin, while DIIs do not.

However, many scholars argue that both DIIs and FIIs can boost firm performance [41]. According to resource-based theory, the social networks of DIIs can provide essential resources for strategy implementation [34]. Institutional theory suggests that DIIs play an active role in improving a firm's strategy implementation and performance [42]. Additionally, agency theory indicates that the shareholding of institutional investors can contribute to improving corporate governance and reducing agency costs [16]. On the basis of these theories, Xiong et al. (2023) presented the results of empirical studies showing that DIIs have a positive effect on corporate performance [41]. DIIs are familiar with national policies and laws and can make better use of local relational resources. They can also improve information symmetry and reduce investment risk through information analysis and transmission [25]. Therefore, the following hypothesis is proposed:

H1-2. *DIIs have a positive impact on corporate value.*

3.2. Relationship between Institutional Investors and ESG

With the emphasis on corporate sustainability, institutional investors attach particular importance to corporate social responsibility [43]. They tend to invest in companies that pursue sustainable development, not just economic profits [44]. They also engage in managerial decisions to obtain long-term investment returns by recognizing the performance of companies in environmental protection and social responsibility and promoting the implementation of ESG by companies [45]. By threatening to withdraw, they put pressure on management, leading it to meet the social responsibility demands of institutional investors to reduce stock price volatility and increase corporate value [46]. By examining an international sample and adopting the perspective of shareholder activism, Dyck et al. (2019) show that institutional investors' shareholding can improve companies' ESG performance and evaluation results [47].

In China, the government's carbon emission reduction targets and the expansion of institutional investors' shareholdings have further strengthened the influence of institutional investors on the management of their investee companies. In examining the impact of institutional investors' shareholding ratio on the social responsibility of A-share listed companies in the Chinese market, one study determined that institutional investors can promote the social responsibility of companies by improving their governance structure [41]. However, the relatively late emergence of the ESG concept in China may have led to differences in the perceived role that DIIs and FIIs play in improving the ESG of companies. According to Welford (2005), the difference in corporate social responsibility is related to the degree of economic development [48]. While policy reforms in the field of social responsibility have progressed rapidly in developed countries, corporate social responsibility is still in its infancy in emerging economies like China [49]. Therefore, FIIs are more likely to recognize and emphasize companies' social responsibility than DIIs in the Chinese market.

FIIs may promote ESG because of their high level of social awareness. More than 90% of foreign investors in Chinese-listed companies are from economically advanced countries in North America, Western Europe, and Northern Europe [50]. In making decisions on investment, these foreign investors are very likely to reflect their own social consciousness and pay attention to environmental and social issues [51]. Tsang et al. (2019) argue that FIIs have led to voluntary information disclosure, and their influence is greater than that of DIIs [52].

Institutional investors from countries emphasizing corporate social responsibility are more likely to be interested in companies' environmental and social responsibility practices. They are expected to actively monitor governance fulfillment. They believe that high environmental and social responsibility levels can bring social rewards to companies and help them avoid social sanctions [47]. Thus, FIIs are more likely to actively strive to improve the ESG of their investee companies to obtain long-term returns. Therefore, the following hypothesis is proposed:

H2-1. *FIIs have a positive impact on ESG.*

Unlike FIIs, DIIs are less likely to put pressure on the socially responsible activities of companies that they have invested in because of their lack of understanding and experience in ESG. In addition, given the institutional immaturity of the Chinese stock market, DIIs may have significant connections and be in collusion with insiders of listed companies [3]. This trend suggests that DIIs in China do not have a significantly positive impact on a company's ESG. Therefore, the following hypothesis is proposed:

H2-2. *DIIs have no significant impact on ESG.*

3.3. Relationship between ESG and Corporate Value

While numerous studies have investigated the impact of ESG on firm performance, their results are inconsistent. Friedman (1970) [16] argues that environmental investments or social responsibility activities beyond the minimum legal requirements can incur additional costs and reduce firm performance. Therefore, many early studies based on this argument contend that ESG may not affect a firm's financial performance and corporate value [53,54].

However, as the ESG investment ideology has spread, and the ESG performance evaluation system has become more specialized and sophisticated, many studies have argued that ESG boosts firm performance (Friede et al., 2015). Through an empirical analysis of more than 2000 companies, Friede et al. (2015) determined that ESG improves performance [55]. ESG activities can reduce stock volatility and risk through efficient strategic decision-making [56], enhance a firm's operating performance [57] and market valuation [58], help maintain favorable relationships with stakeholders, accumulate social capital, and strengthen a firm's competitive advantage [59].

Sustainable development theory argues that firms with higher ESG performance evaluation may achieve higher sustainability and long-term capital value. It also contends that by disclosing ESG-related information, firms can secure social capital and promote sustainable development [60]. According to signaling theory, firms actively performing ESG send positive signals to the market about sustainable development and complement the information asymmetry of institutional investors [43]. Therefore, ESG can increase the trust of institutional investors, reduce the cost of capital through promotional effects, and increase corporate value.

Furthermore, stakeholder theory suggests that stakeholders prefer firms that faithfully fulfill ESG responsibilities, and a firm's fulfillment of ESG responsibilities can attract the attention of stakeholders, helping secure more market resources in the short term and improving the firm's reputation and value [61,62]. By contrast, environmental pollution, lack of social responsibility, and poor corporate governance can harm the interests of employees, local communities, and society; hence, reducing corporate value [63]. Branco and Lucia (2006) argue that positive environmental strategies or social responsibility behaviors can help attract excellent employees, enhance corporate reputation, strengthen interactions with stakeholders, reduce the cost of capital, and limit business risks, thereby increasing a firm's financial performance [64]. The main motivation for practising ESG is to achieve social benefits, corporate value creation, and growth goals. Therefore, the following hypothesis is proposed:

H3. *ESG has a positive impact on corporate value.*

3.4. Mediating Effect of ESG

To help companies raise funds and improve their visibility in the international market, the Chinese government introduced the QFII program in 2002 to open the market for FIIs to invest in Chinese-listed companies. As a result, in recent years, many FIIs, especially from advanced markets, have invested in Chinese-listed companies [65,66]. Furthermore, since 2018, a series of reforms to the QFII program have been implemented, such as simplifying the application process, shortening the period, expanding the investment scope, and strengthening continuous supervision. The QFII reform is expected to strengthen the Chinese capital market, facilitate the inflow of foreign capital, and deepen internal institutional reform.

The shareholding of FIIs can strengthen the monitoring of top management's decision-making and behavior [67], reduce managerial opportunism, decrease agency costs, reduce financing costs, and improve corporate value [3]. It can also provide companies with capital, information, and advanced management experience to promote specialized management and corporate behavior standardization and help maintain social stability [68], strengthen companies' motivation to practice ESG and increase their sustainability and performance [37]. Given these arguments, foreign investors who invest in Chinese- listed

companies are expected to improve the sustainability of Chinese companies by urging them to comply with ESG guidelines [69]. Additionally, with their skilled expertise and high level of social awareness, FIIs are expected to improve corporate value by promoting ESG. Therefore, the following hypothesis is proposed:

H4. *ESG mediates the impact of FIIs on corporate value.*

4. Methodology

4.1. Data Collection and Research Sample

The research sample consists of Chinese companies listed on the Chinese A-share market from 2017 to 2019, before the COVID-19 pandemic. A-share listed companies have a high rate of ESG report disclosure and are systematically evaluated by third-party institutions. They are large and stable, so they are more likely to adopt various methods to improve their sustainable development capabilities. To minimize the possibility of reverse causality, the analysis set a one-year gap between the independent and mediating variables and the dependent variable, considering the time lag of the impact of the independent and mediating variables on the dependent variable. Specifically, data for the independent and mediating variables were from 2017 and 2018, and data for the dependent variable were from 2018 and 2019.

The final sample was selected through the following process: First, financial companies, special treatment (ST) companies (listed companies with two consecutive years of losses), and listed companies with three consecutive years of losses (*ST companies) were excluded from the A-share listed companies according to the 2012 industry classification standard of the CSRC. Next, ESG data were obtained from the Huazheng ESG performance evaluation system on the Wind database, institutional investor shareholding data from the RESSET database, and other financial data from the CSMAR database. Companies with missing values in the process of combining information from various databases were excluded. The final effective observations included in the empirical analysis were 310.

The industry composition of the sample shows that manufacturing companies account for the largest share with 136 (64.8%), followed by transportation, warehousing, and postal services with 16 (7.6%); wholesale and retail trade with 12 (5.7%); electricity, gas, and water supply with 10 (4.8%); real estate with 9 (4.3%); construction with 6 (2.9%); information transmission, software, and information technology services with 5 (2.4%); mining with 4 (2%); water, environment, and public facility management with 3 (1.4%); leasing and business services with 3 (1.4%); agriculture, forestry, and fishing with 2 (1%); accommodation and catering with 2 (1%); scientific research and technical services with 1 (0.5%); and culture, sports, and entertainment with 1 (0.5%).

4.2. Measurement of Variables

4.2.1. Independent Variables

In line with the research purpose, the independent variable—institutional investor type—is split into DIIs and FIIs. Information on their respective shareholding ratios (DIIHoldper) was obtained from the RESSET database. Specifically, the types of institutional investors include QFIIs, funds, securities firms, insurance companies, social security funds, trust funds, and financial companies, where all types other than QFIIs are considered DIIs. Therefore, the shareholding ratio of FIIs was measured by dividing the stock holdings of QFIIs by the total number of shares of the company, and the shareholding ratio of DIIs was measured by dividing the stock holdings of DII by the total number of shares of the company.

4.2.2. Dependent Variable

The performance indicators used in the study can be divided into accounting-based performance measures, such as ROA, ROI, and EPS, and market-based performance mea-

sures, such as Tobin's Q. In this study, Tobin's Q was used as a proxy for corporate value and measured as follows:

Tobin's Q = (Number of circulating shares × Share price + Number of non-circulating shares × Net asset value per share + Book value of liabilities)/Total assets.

Tobin's Q represents the modified corporate value and the growth potential of the firm and is widely used in academic research and investment transactions [39].

4.2.3. Mediating Variable

Many ESG rating agencies use financial data and information provided by third-party independent institutions to evaluate ESG performance and derive a comprehensive ESG score for companies by applying certain weights. This study measured the ESG of the target companies using the Huazheng ESG performance evaluation system data provided by the Wind database. The Huazheng ESG performance evaluation system comprises 3 top-level concepts, 14 secondary concepts, 26 tertiary indicators, and more than 130 sub-data indicators based on the core ESG concepts and experiences, considering the actual situation of the Chinese market. The results comprise nine grades from AAA to C. Therefore, the total ESG performance was measured by assigning scores from 9 to 1 for the AAA–C grades (AAA = 9, AA = 8, A = 7, BBB = 6, BB = 5, B = 4, CCC = 3, CC = 2, C = 1), so that a higher score indicates better ESG performance.

4.2.4. Control Variables

To accurately analyze the effects of the independent variables and the mediating variable on corporate value, the impact of firm size, leverage ratio, listing period, and industry type was controlled as follows: First, firm size is an important factor that affects both independent and dependent variables. Therefore, it is essential to properly measure and control the firm size to ensure the reliability and validity of the study, so this study used the firm size as a control variable. Various methods can be used for measuring the firm size, such as total assets, sales, and number of employees, but this study used total assets, which reflect the overall firm size well and have relatively low volatility over time [70]. Specifically, the natural log value of total assets was used to improve the normality of the distribution. Firm size is related to the company's internal control capability, the strength of governance norms, and risk aversion capability. In other words, the larger the firm size, the more investment and production it can bring to the firm; it can promote profits and development, but it can also lead to an increasingly complex shareholder structure, low governance efficiency, and low decision-making efficiency [71]. When a company's size reaches a certain level, fulfilling social responsibility and good corporate governance may become challenging [33]. Therefore, the effect of firm size, measured by the natural logarithm of total assets at the end of the year, was controlled.

The debt ratio, which represents the debt level of the company, reflects the potential risk level and financial stability of the company. Companies with high debt ratios may go bankrupt if their cash flow is disrupted; hence, the debt ratio can damage corporate value [72]. Therefore, the effect of the asset-liability ratio, measured as the ratio of total liabilities at the end of the year to total assets was controlled.

The longer the listing period of a company, the more likely it is to be recognized for its high capabilities and experience and raise more investment and funds [73]. Additionally, the listing period of a company is related to information asymmetry or visibility, which can affect the investment decision-making of institutional investors [74]. Therefore, the effect of the listing period, measured as Ln (current year—listing year + 1), was controlled in the analysis.

Finally, to control for the effects of industry-type differences, the target companies were divided into manufacturing and other industries based on the industry classification standard of the CSRC; a dummy variable (manufacturing = 1, other = 0) was employed to control for the effect in the analysis.

4.3. Method

To analyze the mediating effect, we conducted a three-step regression analysis test by Baron and Kenny (1986) [75]. Their "causal steps approach" for testing the mediation effect involves sequentially testing the individual impact of each path to confirm the existence of an indirect (mediation) effect. However, this method has limitations in statistically inferring the magnitude of indirect effects. Specifically, it is difficult to accurately estimate the size of the impact of the independent variable on the dependent variable through the mediating variable [76]. To compensate for these limitations, this study also used the bootstrap confidence interval setting method. This method enables statistical inference on the indirect effect expressed as the effect size (regression coefficient) of the "independent variable-mediator path" and the "mediator-dependent variable path".

In the context of this study, the difficulty in estimating the mediation effect primarily stems from the use of cross-sectional data and the complex relationship between institutional investors, ESG performance, and corporate value in the Chinese market. Cross-sectional data makes it difficult to clearly identify causal relationships over time, and the unique nature of the Chinese market may further complicate the relationship between institutional investors, ESG performance, and corporate value. The bootstrap method can overcome some of these limitations. This method provides more robust estimates of the indirect effect and its confidence interval even in situations where the normality assumption may not be met [77]. Therefore, this method enabled this study to more accurately analyze the impact of institutional investors' stake on corporate value through ESG.

5. Results

Table 1 presents the descriptive statistics, including the mean and standard deviation of the variables included in the empirical analysis and the Pearson's correlation between the variables. The mean values of the main variable, Tobin's Q, FII, DII, and ESG, are 1.52, 0.01, 0.53, and 4.35, respectively. The independent variables, FII (r = 0.149, $p < 0.05$) and DII (r = 0.244, $p < 0.01$), are positively correlated with the mediating variable, ESG. Meanwhile, the independent variable, FII, shows a positive correlation (r = 0.256, $p < 0.01$) with the dependent variable, corporate value, and the mediating variable, ESG, also exhibits a significantly positive correlation (r = 0.158, $p < 0.05$) with the dependent variable, corporate value. To check for multicollinearity, the variance inflation factor (VIF) was calculated for all variables; it was less than 10 (1.048–1.731), indicating a very low likelihood of errors in the analysis results due to multicollinearity.

Table 1. Descriptive statistics and Pearson's correlation.

Variables	M	SD	1	2	3	4	5	6	7	8	9	10	11
Corp. Value	1.52	0.70	1										
FII	0.01	0.01	0.256 **	1									
DII	0.53	0.21	−0.004	−0.143 *	1								
ESG	4.35	0.97	0.158 *	0.149 *	0.244 **	1							
E	1.91	1.12	0.071	0.140 *	0.193 **	0.429 **	1						
S	4.55	1.88	0.082	0.178 **	0.156 *	0.692 **	0.289 **	1					
G	5.71	1.17	0.139 *	−0.02	0.087	0.535 **	−0.074	0.015	1				
Firm size	22.95	1.39	−0.308 **	0.039	0.459 **	0.273 **	0.271 **	0.256 **	0.003	1			
Debt ratio	0.42	0.19	−0.397 **	−0.059	0.222 **	−0.014	0.175 *	0.163 *	−0.329 **	0.557 **	1		
Listing period	2.31	0.93	−0.150 *	0.149 *	0.205 **	0.053	0.093	0.055	−0.067	0.480 **	0.286 **	1	
Industry dummy	0.65	0.48	0.294 **	0.109	−0.196 **	−0.013	0.024	−0.087	0.067	−0.228 **	−0.334 **	−0.164 *	1
Corp. value	VIF (tolerance)			1.048 (0.955)	1.290 (0.775)	1.139 (0.878)	1.115 (0.897)	1.122 (0.891)	1.200 (0.833)	1.731 (0.578)	1.552 (0.644)	1.304 (0.767)	1.133 (0.883)

Note: * $p < 0.05$, ** $p < 0.01$.

Table 2 presents the results of the three-step regression analysis conducted to verify the mediation effect proposed in the research hypotheses [75]. Step 1 shows the impact of the institutional investor (foreign, domestic) ownership ratio on corporate value. Models 1 and 2 in Table 2 present the regression analysis results regarding the total effect of the shareholding of DIIs and FIIs on corporate value. The analysis results indicate that

the explanatory power of Models 1 and 2 is 23% and 20.4%, respectively. Among the control variables, the coefficient on the industry dummy is significant, indicating that manufacturing companies' value is higher than that of service companies. Additionally, Model 1 shows that the shareholding of FIIs has a positive impact (β = 0.234, $p < 0.001$) on corporate value, and Model 2 shows that the shareholding of DIIs has a positive effect (β = 0.186, $p < 0.01$) on corporate value. Therefore, H1-1 and H1-2 are supported.

Table 2. Multiple regression analysis.

	Tobin's Q		**ESG**		**Tobin's Q**
***n* = 210**	**Model 1**	**Model 2**	**Model 3**	**Model 4**	**Model 5**
	β t	***β t***	***β t***	***β t***	***β t***
Firm size	−0.129 (−1.619)	−0.214 * (−2.432)	0.448 *** (5.246)	0.383 *** (4.120)	−0.212 * (−2.531)
Debt ratio	−0.254 ** (−3.357)	−0.259 ** (−3.362)	−228 ** (−2.819)	−0.229 ** (−2.817)	−0.212 ** (−2.798)
Listing period	−0.025 (−0.358)	0.022 (0.308)	−0.121 (−1.611)	−0.092 (−1.242)	−0.003 (−0.042)
Industry dummy	0.150 * (2.305)	0.198 ** (2.999)	−0.022 (−0.319)	0.010 (0.146)	0.154 * (2.409)
FII	0.234 *** (3.765)		0.139* (2.095)		0.208 ** (3.376)
DII		0.186 ** (2.656)		0.140 (1.899)	
ESG					0.184 ** (2.858)
F	13.506 ***	11.733 ***	6.665 ***	6.487 ***	13.012 ***
R2	0.249	0.223	0.140	0.137	0.278
Adj R2	0.230	0.204	0.119	0.116	0.256

Note: β is the standardized regression coefficient; *** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$.

Step 2 shows the impact of the institutional investor (foreign, domestic) ownership ratio on ESG. Models 3 and 4 in Table 2 present the results of the multiple regression analysis with institutional investor shareholding as the independent variable and ESG as the dependent variable. Models 3 and 4 have an explanatory power of 11.9% and 11.6%, respectively. Among the control variables, firm size and debt ratio have a significant impact on ESG. This result indicates that the larger the firm size, and the lower the debt ratio, the higher the ESG performance evaluation score. Additionally, Model 3 shows that the shareholding of FIIs has a positive impact (β = 0.139, $p < 0.05$) on ESG, while Model 4 indicates that the effect of DII shareholding on ESG (β = 0.140, $p > 0.05$) is not statistically significant. Therefore, H2-1 and H2-2 are supported.

Step 3 shows the mediating effect of ESG on the relationship between FII ownership and corporate value. The regression analysis results conducted to identify the impact of the mediating variable, ESG, on corporate value, while controlling for the effects of institutional investors, are shown in Model 5 in Table 2. Among the control variables, firm size, debt ratio, and industry type have a statistically significant impact on corporate value. Additionally, a statistically significant positive relationship (β = 0.184, $p < 0.01$) is observed between the mediating variable, ESG, and the dependent variable, corporate value, supporting H3.

Finally, a significant positive relationship (β = 0.208, $p < 0.01$) is observed between the independent variable, FII, and the dependent variable, corporate value. However, the degree of this impact is reduced when the mediating variable, ESG, is included. This result indicates that the mediating variable, ESG, partially mediates the relationship between the independent variable, FII, and the dependent variable, corporate value, supporting H4.

Next, Table 3 shows the Bootstrap confidence interval verification results regarding the mediating effect of the FII ownership ratio on corporate value. The analysis results show that both the total impact (b = 16.8704, CI = 8.0366–25.7043) and the indirect effect (b = 1.8458, CI = 0.4404–4.2783) of FIIs on corporate value are significant. This result implies that the higher the shareholding of FIIs, the better the ESG performance, which contributes to improving corporate value. Even though all indirect effects are significant, the direct impact of the "foreign institutional investors–firm value path" (b = 15.0247,

CI = 6.2489–23.8004) is still significant, confirming that ESG partially mediates the relationship between FIIs and corporate value.

Table 3. Bootstrap 95% confidence interval test for the indirect effect (mediating effect).

Path	B	SE	Boot LLCI	Boot ULCI
Total effect (QFII–firm value)	16.8704	4.4804	8.0366	25.7043
Direct effect (QFII–firm value)	15.0247	4.4508	6.2489	23.8004
Indirect effect (QFII–ESG–firm value)	1.8458	1.0051	0.4404	4.2783

6. Conclusions

6.1. Summary of the Research Findings

This study examined the impact of DIIs and FIIs that have invested in large, stable, and ESG-reporting Chinese A-share listed companies on corporate value. The study's findings are summarized as follows: First, the shareholding of both FIIs and DIIs enhances corporate value. Second, the shareholding of FIIs strengthens the company's ESG, while the shareholding of DIIs does not significantly affect it. Third, ESG has a positive impact on corporate value. Fourth, ESG partially mediates the positive relationship between the shareholding of FIIs and corporate value.

6.2. Discussion

First, both foreign institutional investors (FIIs) and domestic institutional investors (DIIs) enhance corporate value, supporting both H1-1 and H1-2 as well as the hypothesis of effective monitoring by institutional investors. Institutional investors use their expertise and resources to supervise corporate management, alleviate agency problems, and reduce information asymmetry. This result is consistent with Chen et al. (2007) [31] and Aggarwal et al. (2011) [38], emphasizing the important role that institutional investors play in improving corporate governance and performance.

Second, H2-1 is supported, showing that FIIs' shareholdings enhance corporate ESG performance. This indicates that FIIs promote corporate sustainability based on global ESG standards and high social awareness levels. This finding, which is consistent with Dyck et al. (2019) [47], suggests that FIIs pressure investee companies to adopt advanced ESG practices and encourage sustainable management methods for long-term value creation.

Third, the DIIs' shareholding ratio did not significantly affect ESG performance, supporting H2-2. This result can be seen as reflecting the lack of understanding and experience of ESG among domestic institutional investors in China and the immature institutional environment of the Chinese stock market. It suggests that domestic institutional investors in China do not yet consider ESG as a major factor in investment decisions or do not play an active role in improving ESG performance.

Fourth, H3 was supported as ESG performance had a positive effect on corporate value. This is consistent with studies [55,58] indicating that ESG activities enhance the long-term sustainability and value of a company. It suggests that companies with high ESG performance can create higher corporate value in the long term through improved risk management capabilities, improved relationships with stakeholders, and enhanced reputation.

Finally, H4 was supported as ESG partially mediated the relationship between FIIs' shareholding ratio and corporate value. These mediating effects show that FIIs do not simply directly increase corporate value; they also indirectly contribute to corporate value enhancement through improved ESG performance. This highlights the multidimensional impact of FIIs and the mechanism of sustainable value creation through ESG.

These comprehensive results highlight the importance of attracting FIIs and the need for improved ESG performance for Chinese companies and suggest the importance of promoting FII investment and improving ESG-related systems for policymakers.

6.3. Contributions of the Study and Implications

The academic implications of this study are as follows: First, the literature on sustainable management argues that ESG is an important factor to consider in the process of investment decision-making by institutional investors. However, research on the relationship between institutional investors and ESG in Chinese companies is scarce, and few studies have compared the differential impact of institutional investors, by explicitly distinguishing between domestic and foreign investors. This study fills this gap in literature.

Second, the research results show that by exercising their supervisory authority as shareholders, socially aware and highly informed FIIs can help monitor the opportunistic behavior of management and contribute to the company's sustainable development and value enhancement. This result highlights the importance of research that considers the causal relationship between corporate governance systems and sustainable management and can provide motivation for conducting convergence research in these fields.

The study also provides several practical implications for stakeholders, including policymakers and business leaders. First, it has been empirically proven that increasing the stake of institutional investors, especially FIIs, has a positive impact on the ESG performance and corporate value improvement of Chinese companies. This suggests that the Chinese government and policymakers need to promote the growth of institutional investors and improve the capital market. Although the introduction of the QFII system has already achieved gradual results, the current stake ratio of QFIIs is still low, which does not provide sufficient incentives for improving corporate governance and performance. Therefore, policymakers should consider the following measures: (1) gradually increase the QFII investment quota and simplify the investment process to promote the participation of institutional investors, (2) improve the incentive structure, introduce tax benefits or other incentives for companies with excellent ESG performance to encourage companies to improve their ESG efforts, and (3) strengthen and standardize ESG disclosure requirements to make it easier for investors to evaluate companies' ESG performance. These policies will promote the increase in the stake ratio of QFIIs, which will eventually lead to improved ESG practices and corporate value of Chinese companies.

Second, Chinese companies should strengthen their awareness of environmental and social responsibility and provide more information to investors to reduce information asymmetry. Currently, the Chinese government and stakeholders recognize the importance of ESG, as evidenced by President Xi Jinping's declaration at the 75th UN General Assembly in September 2020 that carbon emissions will peak by 2030 and carbon neutrality by 2060 [3]. Accordingly, the investment concept of institutional investors is changing from one of pursuing short-term profits to one of corporate sustainability. This change promotes institutional investors' interest in and contribution to the environment, social responsibility, and corporate governance and encourages shareholder activism among institutional investors. Therefore, companies should actively practice ESG to strengthen investment from institutional investors and implement the following recommendations: (1) Strengthen ESG strategies. Companies should integrate ESG into their core business strategies and set clear ESG goals and Key Performance Indicators. (2) Resolve information asymmetry. Establish a transparent and comprehensive reporting system for ESG performance to provide more information to investors. This will help investors make decisions and strengthen trust between companies and investors.

6.4. Limitations and Future Research Directions

Despite the theoretical and academic implications mentioned above, this study has the following limitations that subsequent studies can complement: First, institutional investors were classified into DIIs and FIIs. Subsequent studies that classify institutional investors based on factors such as their shareholding period and investment motives may help explain the differential impact of different types of institutional investors on corporate strategy and value. Second, to minimize the effect of rapid external environmental changes, the study sample was drawn from Chinese companies listed on the Chinese A-share market

from 2017 to 2019, before the COVID-19 pandemic. However, during this period, the QFII program was still in the development stage in China; hence, both the number and shareholding ratio of QFII participants among Chinese listed companies were limited. Future studies using data covering the COVID-19 pandemic period can complement these limitations. Third, Tobin's Q was used to measure corporate value as the dependent variable in the study. Subsequent studies using accounting performance indicators such as ROA, ROI, and EPS may increase the practical value of the research results.

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