



Vaasan yliopisto
UNIVERSITY OF VAASA

Henrik Hyytiäinen

Is High ESG Performance a Cause or a Consequence?

School of Accounting and Finance
Bachelor's Thesis in Finance
Accounting and Finance

Vaasa 2025

UNIVERSITY OF VAASA**School of Accounting and Finance**

Author: Henrik Hyytiäinen
Title of the thesis: Is High ESG Performance a Cause or a Consequence?
Degree: Bachelor of Science in Economics and Business Administration
Degree Programme: Finance
Supervisor: Veda Fatmy
Year: 2025 **Pages:** 39

ABSTRACT:

This thesis examines whether high Environmental, Social, and Governance (ESG) performance is a cause of corporate outcomes or a consequence of prior financial strength. Using a structured review of recent finance research, I synthesize two causal channels into a unified framework: *a consequence channel*, where financial slack and fewer constraints enable ESG investment (CFP → ESG), and *a valuation channel*, where credible ESG improves cash flows, lowers risk, and raises valuation (ESG → Valuation).

Stakeholder, agency, and legitimacy theories explain when each channel dominates and why the literature often finds mixed results. I conclude that ESG is frequently a consequence of financial strength (H1), while valuation benefits are conditional on the credibility of disclosure, governance quality, and context (e.g., high-salience industries, intense scrutiny). The review highlights pervasive measurement fragmentation, rating disagreement, and greenwashing, all of which dilute identification and bias estimated effects. I formalize a dynamic loop in which financial strength enables ESG choices, and the credibility of those choices determines their payoffs.

KEYWORDS: ESG, Corporate Financial Performance (CFP), Market Valuation, CSR, Causality, Credibility

Contents

| | | |
|-----|--|----|
| 1 | Introduction | 5 |
| 1.1 | Purpose of the Study | 6 |
| 1.2 | Structure of the Study | 8 |
| 2 | Theoretical Background | 9 |
| 2.1 | CSR Framework | 9 |
| 2.2 | Environmental, Social and Governance (ESG) | 10 |
| 2.3 | Stakeholder Theory | 12 |
| 2.4 | Agency Theory | 14 |
| 2.5 | Legitimacy Theory & Greenwashing | 15 |
| 2.6 | Measures of Corporate Performance | 18 |
| 3 | Literature Review | 20 |
| 3.1 | ESG as a Driver of Financial Performance | 21 |
| 3.2 | ESG as a Consequence of Financial Performance | 23 |
| 3.3 | ESG and Market Valuation | 25 |
| 3.4 | Greenwashing, Measurement Problems & ESG Rating Disagreement | 27 |
| 4 | Practical Implications and Suggestions for Future Research | 30 |
| 5 | Conclusion | 32 |
| | References | 35 |

Figures

| | |
|--|----|
| Figure 1. Contrasting Models of the Corporation: The Stakeholder Model (Donaldson & Preston, 1995). | 13 |
| Figure 2. Qualitative Classes of Stakeholders (Mitchell et al., 1997). | 14 |
| Figure 3. Development of sample companies' average apparent and real environmental performance over time (Kathan et al., 2025). | 17 |
| Figure 4. Cumulative fund flows by sustainability rating (Hartzmark & Sussman, 2019). | 23 |

Equations

| | |
|--|----|
| Equation 1. Tobin's Q (Islam et al., 2025). | 18 |
| Equation 2. Return on Assets (ROA). | 19 |

1 Introduction

Sustainability has become a universal concern that unites industries, companies, and individuals around a common goal. Environmental, Social, and Governance (ESG) factors are increasingly central to corporate decision-making, as stakeholders and regulators demand greater transparency and accountability. Interest in ESG reporting has grown significantly in the last few decades, and the results are clear: in 2011, only 20% of S&P 500 firms issued sustainability or corporate responsibility reports, compared with 2018, when it increased to 86% (Gillan et al., 2021). While ESG disclosures primarily target investors, Corporate Social Responsibility (CSR) initiatives often emphasize broader commitments to society. Stakeholders tend to trust high-CSR firms more than low-CSR firms (Lins et al., 2017). At the same time, it is possible that high performing firms could invest more in CSR because of extra cash flow, and through better CSR, make the performance more efficient. This raises a central question: Do good ESG practices lead to better financial performance, or do successful firms simply have more resources to devote to ESG?

The sharp rise in ESG reporting, particularly among large U.S. corporations, reflects several drivers, especially consumer demand. As Foley et al. (2024) note, consumers increasingly prefer companies that combine product quality with responsible, ethical, and environmentally conscious operations. Regulation has also played a role: Becker et al. (2022) show that the introduction of the Sustainable Finance Disclosure Regulation (SFDR) in the EU led to significant increases in sustainability ratings and net fund inflows to affected funds.

However, the rapid institutionalization of sustainability reporting has also created new challenges. In a recent study, Kathan et al. (2025) find that apparent environmental performance and ESG scores have a strong positive correlation and therefore ESG scores are unsuitable for measuring a company's actual environmental impact. Sulkowski & Jebe (2022) also find several reasons why an ESG score is not always a good proxy for a firm's actual environmental impact. They argue that ESG scores rely on voluntary disclosures from a fragmented set of standards (GRI, SASB, CDP, etc.) that use different definitions

of materiality, so the underlying data are incomparable across firms. Sulkowski & Jebe (2022) show that managers can selectively disclose, exploit divergent materiality standards, and engage in regulatory arbitrage, while assurance remains weak. Unlike ESG reporting, financial reporting is governed by simplified, mandatory standards created by governments. ESG reporting is a polycentric system with more complex and inconsistent standards. Sulkowski & Jebe (2022) advocate for government-mandated, unified standards akin to financial reporting frameworks.

While increased awareness and transparency are broadly positive, the expansion of ESG also introduces legitimacy risks, including greenwashing, selective or misleading disclosure, “rating shopping” and reputational damage. According to Pástor et al. (2021), sustainable investing enhances social welfare through two channels: firms become greener due to higher valuations, and capital flows shift from brown to green firms as financing costs diverge. This dynamic underscores the importance of understanding whether ESG performance is a driver or a consequence of firm success.

1.1 Purpose of the Study

The purpose of this study is to examine the relationship between Environmental, Social and Governance (ESG) performance and corporate success. Specifically, this thesis investigates whether the ESG factor acts as a cause or a consequence of corporate financial performance (CFP) and market valuation. Sustainability reporting has expanded in the 21st century (Gillan et al., 2021) and it is obvious that it keeps growing. Understanding its direction of influence becomes crucial for both managers and investors, because firms can use ESG either as a value-creating strategy or a disclosure-driven signal. Only by identifying whether ESG causes better outcomes or merely follows them can we tell if sustainability investment creates shareholder value or simply reallocates existing resources.

It is also likely that ESG disclosure will become more transparent through future legislation. According to Sulkowski & Jebe (2022), the clearest path towards a less fragmented

ESG reporting standard is through regulation by governments, not private standard setters.

The relationship between a company's ESG performance and its financial performance is a widely studied and debated topic in corporate finance, and the existing literature offers mixed evidence. Some studies find a positive relationship between ESG and CFP (Gillan et al., 2021; Albuquerque et al., 2018; Lins et al., 2017), while others report neutral or even negative effects (Buchanan et al., 2018; Pástor et al., 2021; Janz et al., 2025; Harrison & Kacperczyk, 2009). The relationship between ESG performance and CFP is often bi-directional. From a resource-based view, financially successful companies are likely to possess the necessary resources to invest in ESG initiatives, meaning financially unconstrained firms spend more on social goodness (Dimson et al., 2015; Krüger, 2015). This mechanism implies that ESG often follows a firm's established profitability (Vaihekoski & Yahya, 2023) even when it may later create value, and that is why I hypothesize that corporate financial performance more often enables stronger ESG initiatives, implying that the ESG factor acts as a consequence rather than a cause.

H1: ESG performance is more often a consequence of corporate financial performance than a cause.

When reviewing a company's market valuation relationship with ESG factors or Corporate Social Performance (CSP), it gets more context-dependent and influenced by a wide range of different factors: economic conditions, investor beliefs, risk of greenwashing, and agency problems. In this context also, there are many studies that found a positive relationship (Islam et al., 2025; Gao & Zhang, 2015; Lueg & Pesheva, 2021). However, the most prevalent view is that ESG performance and market valuation have mixed relationships (Bifulco et al., 2023; Gillan et al., 2021; Vaihekoski & Yahya, 2023) because there are challenges in measurement and greenwashing (Kathan et al., 2025; Agoraki et al., 2025). For stakeholder and legitimacy perspectives, credibility can lower the risk and cost of capital (Lins et al., 2017; Pástor et al., 2021). When corporate governance and

reporting credibility are strong and stakeholder trust exists, ESG performance generally supports firm valuation because this credibility validates the true, value-enhancing benefits of sustainability.

H2: ESG performance tends to enhance market valuation, particularly when reporting credibility is high.

This study contributes to the ongoing debate on whether ESG performance is a cause or a consequence of firm success. By integrating Stakeholder, Agency, and Legitimacy theories, it provides a unified framework explaining both value-enhancing and self-serving motives behind corporate sustainability. This paper highlights how financial strength may enable ESG investment (“consequence effect”), while credible ESG actions can enhance valuation and investor trust (“cause effect”). By distinguishing these dual channels and emphasizing the role of reporting credibility, this research advances understanding of the bi-directional link between ESG and firm performance.

1.2 Structure of the Study

This thesis is organized into five main chapters. Chapter 1 introduces the topic, states the purpose of this study, and presents the hypotheses. Chapter 2 explains the theoretical background of important theories and terms that are relevant for the study and the industry. Chapter 3, the core of the study, critically reviews and synthesizes the most relevant literature to answer my research questions. Chapter 4 presents practical implications, which enhance the thesis’s effectiveness, and offers suggestions for future research. The last chapter summarizes the main findings of the literature review and presents the conclusions.

I also want to note that AI (ChatGPT-5) has been used to assist with structuring, language refinement, and improving the overall clarity of the text. All research and analysis are conducted by the author.

2 Theoretical Background

This chapter provides the theoretical foundations for analyzing the nature of the relationship between corporate social and financial performance. It begins with a brief overview of normative frameworks, Corporate Social Responsibility (CSR) and Corporate Social Performance (CSP), followed by the emergence of ESG as an investor-oriented framework.

The final sections of this chapter review the main theories (Stakeholder, Agency and Legitimacy) and the concept of greenwashing that explain how ESG engagement may influence or be influenced by firm success. It is crucial to understand these core theories to fully engage with the central discussion of this thesis.

2.1 CSR Framework

Corporate social responsibility (CSR) refers to corporate actions that go beyond the law (McWilliams & Siegel, 2001). The framework of CSR started to form decades ago, and it has evolved into a broad normative framework that is still studied. A normative framework is a set of ethical standards and moral principles that guide a corporation's ethical actions, such as human rights, safeguarding the environment and promoting social welfare (McWilliams & Siegel, 2001).

Carroll (1979) divides the framework into four sections that society expects businesses to assume: economic, legal, ethical, and discretionary responsibilities, reflecting the multidimensional nature of corporate obligations. McWilliams & Siegel (2001) define CSR as "actions that appear to further some social good, beyond the interests of the firm and that which is required by law". Over time, CSR evolved from an ethical concept into a strategic tool that firms employ to enhance reputation, mitigate risk, and build stakeholder trust.

Corporate Social Performance (CSP) translates CSR into measurable outcomes and policies. Carroll's (1979) three-dimensional model (responsibility categories, social issues, and response philosophy) remains a key framework for evaluating firms' societal behaviour. CSP captures the observable impact of CSR, allowing researchers to assess whether firms that "do good" also "perform well".

In the modern world, it is standard that global corporations have their own CSR policy. It has become an integral part of business practice, and corporations typically have a section in their annual report to illustrate their CSR achievements (Servaes & Tamayo, 2013). According to Albuquerque et al. (2018) CSR's increasing use in corporate strategy and its growing popularity inside boardrooms has outpaced the research needed to justify the use of CSR in so many aspects. Lins et al. (2017) note that to measure firms' social capital, they focus on firm's CSR, reflecting the view that CSR captures an organization's relationships with key stakeholders.

Yet the direction of causality remains disputed: firms with stronger financial resources may simply have greater capacity to invest in CSR, suggesting that financial performance can precede social performance, rather than follow it. In other words, some companies may appear to be CSR leaders primarily because their prior success provides the discretionary slack needed to fund CSR initiatives. This ambiguity underlines the central question of this study.

2.2 Environmental, Social and Governance (ESG)

The ESG concept emerged in the early 21st century as a more standardized, investor-focused extension of CSR. While CSR emphasizes ethical responsibility, ESG offers quantifiable metrics that enable financial markets to integrate sustainability factors into investment decisions. It is crucial to acknowledge that each pillar captures a distinct dimension of corporate behaviour: environmental management, social equity, and corporate governance quality (Buchanan et al., 2018). Assaf et al. (2024) describe ESG as an umbrella term. By that, they mean that ESG functions as a catch-all label that masks the

underlying diversity of attitudes and values that investors hold toward the individual criteria, making a single ESG score insufficient for matching the nuanced preferences of many investors (Assaf et al., 2024).

According to Zhang et al. (2024), 2007–2013 marked the *budding period* of ESG research, when the first relevant papers began to appear. 2013–2017 was the development period of ESG research field, during which the number of ESG studies rose steadily. In 2016, the Paris Agreement was signed, and Morningstar released the first global sustainability ratings for 20,000 funds (Morningstar, 2016). From 2017 to the present (2024), the field has expanded rapidly: the 2017 United Nations Environment Assembly initiative “Toward a Zero-Pollution Planet” catalyzed a surge of environmental-protection and sustainable-development research across sectors (Zhang et al., 2024).

ESG scores/ratings are non-financial variables used to measure a company’s ethical performance, based on data gathered by third-party providers from disclosures, media, registries, and other sources. Because of the numerous third-party providers, ESG ratings have several disagreements, which are highlighted when comparing companies’ ESG profiles (Martiny et al., 2024). The ESG score is used as a tool similarly to CSR/CSP, but while CSR/CSP remains a broader managerial/ethical concept, ESG is investor-facing and is typically measured by separately for each pillar.

How has this data been gathered by third parties, and what are the indicator types in ESG measurement? The most common sources to collect information for ESG measurement are publicly available information like corporate reports and regulatory registries, which KLD’s analysts rely on (Krüger, 2015). News items that affect a firm’s stakeholders, such as a newspaper story describing bad labor conditions at a plant or a non-governmental report about waste disposal, are especially important for measuring corporate social responsibility (Krüger, 2015). There is also data from multiple communication channels including “email correspondence, phone interviews, survey responses, and, when feasible, face-to-face interviews.” (Islam et al., 2025).

The rise of mandatory sustainability regulations (e.g., the EU's SFDR) and investor pressure for transparency have further increased firms' incentives to report high ESG scores, regardless of actual performance (Foley et al., 2024). Because such scores can capture genuine operational improvements or strategic disclosure, observed ESG ratings often mix substance with symbolism. If the ratings capture substantive changes, ESG can boost cash flow and firm valuation, but if they mainly reflect the amount of disclosed information, high ESG scores may simply be a consequence of earlier success or strong governance. Therefore, it is critical to determine whether strong ESG signals cause improved performance or merely follow it.

2.3 Stakeholder Theory

The stakeholder theory, "the most widely used theoretical framework" (McWilliams & Siegel, 2001), was popularized by R. Edward Freeman in his landmark book: *Strategic Management: A Stakeholder Approach* (1984). It provides the foundational logic for why ESG performance might cause better financial outcomes, and it attempts to systematically answer a fundamental question: "Which groups are stakeholders deserving or requiring management attention, and which are not?" (Mitchell et al., 1997). A firm is a nexus of relationships with multiple groups who can affect or are affected by the firm's activities (stakeholders), not only owners (shareholders). Figure 1 reframes the firm away from the basic input-output model toward a more practical and accurate model (Donaldson & Preston, 1995).

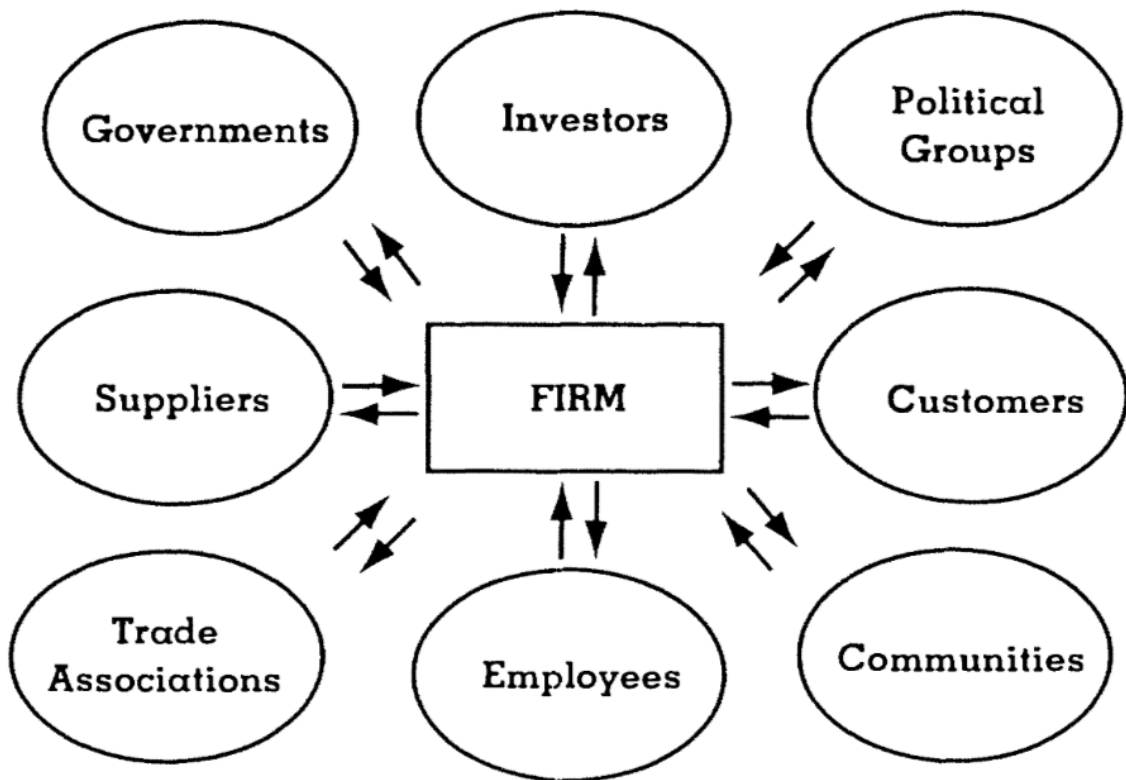


Figure 1. Contrasting Models of the Corporation: The Stakeholder Model (Donaldson & Preston, 1995).

Donaldson & Preston (1995) find that one of the central problems in the evolution of stakeholder theory is the confusion about its nature and purpose. It differs from the other theories in fundamental ways; it's intended both to explain and to guide structure and operation of the corporation. Donaldson & Preston (1995) articulate the theory from three alternative aspects: Descriptive/empirical, explaining how firms actually behave; instrumental, predicting how stakeholders' management influences performance (e.g., profitability, growth); and normative, prescribing ethical duties (Donaldson & Preston, 1995).

Mitchell et al. (1997) argue that there is no individual organizational theory which could answer questions about stakeholder identification in a systematic and efficient way and therefore they develop a managerial, perceptual theory that managers allocate attention (salience) according to three attributes of claimants: power, legitimacy and urgency. They argue that stakeholder salience (the extent to which managers give priority to a

stakeholder) rises when the stakeholder has more following attributes: “(1) the stakeholder’s *power* to influence the firm, (2) the *legitimacy* of the stakeholder’s relationship with the firm, and (3) the *urgency* of the stakeholder’s claim on the firm” (Mitchell et al., 1997). In addition, they form a typology using Venn diagram logic (Figure 2) to combine the three attributes to generate stakeholder classes: “Latent” stakeholders: low salience class (areas 1, 2 and 3); “expectant” stakeholders: moderately salient stakeholders (areas 4, 5 and 6); “definitive” stakeholders: highly salient stakeholders (area 7) (Mitchell et al., 1997).

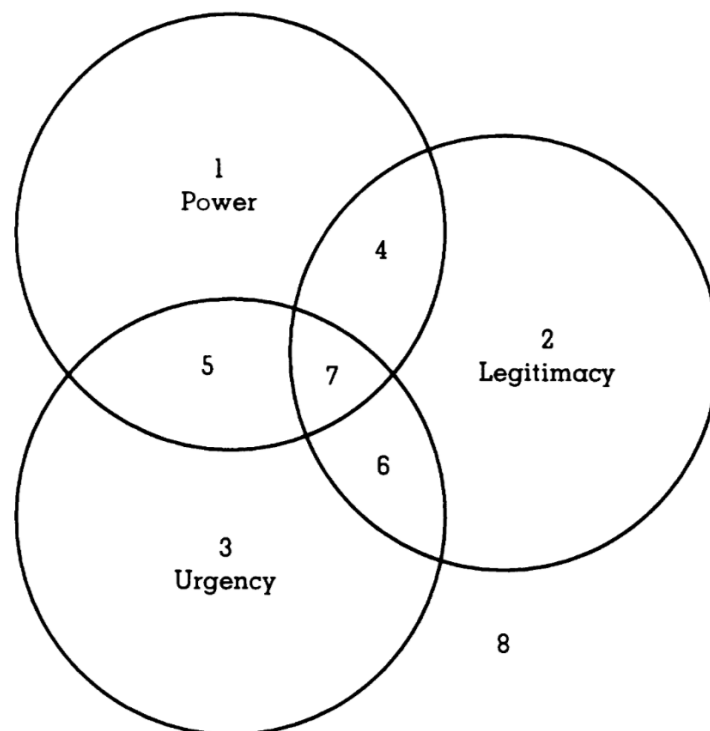


Figure 2. Qualitive Classes of Stakeholders (Mitchell et al., 1997).

2.4 Agency Theory

Agency theory offers an alternative explanation in which ESG engagement is a consequence rather than a cause of firm performance. Jensen & Meckling (1976) are recognized as the developers of the theory, and according to them, agency theory explains the relationship between principals (e.g., shareholders) and agents (e.g., managers or executives) who are hired by the principals to act on their behalf. The central problems are

goal divergence and information asymmetry between principals and agents. Jensen & Meckling (1976) argue that if both parties in the relationship (principals and agents) aim to maximize their results, there is a good chance that the agents do not always act in ways that are beneficial to the principals. Managers may pursue their own goals, such as higher compensation or prestige, rather than maximizing shareholder value. This misalignment creates agency costs, which Jensen & Meckling (1976) define as the sum of: “the monitoring expenditures by the principals, the bonding expenditures by the agent, and the residual loss”.

To minimize the conflicts that agency costs bring, organizations implement governance mechanisms that aim to align managerial behavior with shareholder interests. Zhang et al (2024) find that board oversight and board design, such as independent directors, separate CEO/chair and strong audit committees, are repeatedly identified as governance levers that reduce agency risk and improve ESG outcomes when effective. Studies argue that corporate financial and audit reporting should be external, as well as assurance and analyst coverage (Jensen & Meckling, 1976; Sulkowski & Jebe, 2022; Kathan et al., 2025). When governance mechanisms function well, ESG policies are more likely to represent value-enhancing commitments rather than symbolic gestures, potentially reversing the direction of causality. There is also evidence that influential institutional ownership (IO) mitigates agency problems through monitoring managerial actions and allocating the firm’s resources (Buchanan et al., 2018).

2.5 Legitimacy Theory & Greenwashing

Legitimacy theory is based on the idea that organizations continually seek to be accepted as legitimate by society. The company’s survival depends largely on its reputation, and reputation is tied to expectations and norms of the community in which the company operates. Suchman (1995) describes: “Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions.”. According to Mitchell et al. (1997) Suchman’s definition is difficult to operationalize. However, the

sociological view foregrounds legitimacy as collective, perceptual, and “desirable social good”, not just purely instrumental.

Legitimacy theory provides a strong theoretical foundation for understanding why companies pursue ESG disclosure and corporate sustainability behavior, even though it is not legally mandatory in certain circumstances. In Suchman’s (1995) study, there are three types of organizational legitimacy channels which are still relevant in recent studies and can be presented via current examples: **Pragmatic** (instrumental) channel – exchange and customer/investor demand: A company can provide material benefits with ESG/CSR actions and generate pragmatic legitimacy, increase sales, and reduce operating expenses or lower cost of capital (Suchman, 1995; Albuquerque et al., 2018). **Moral/reputational** channel – trust and social capital: CSR has a considerable influence on company’s resilience, debt access, sales or returns when it comes to negative shocks in markets so it can function as “insurance” in crises (Lins et al., 2017; Albuquerque et al., 2020). Investing in social capital creates trust between company and both its stakeholders and investors and it pays off, especially in crises: “The economic importance of social capital in explaining stock returns is at least half as large as the effect of cash holdings and leverage” (Lins et al., 2017). **Cognitive** channel – taken-for-grantedness and comprehensibility: As sustainability becomes a taken-for-granted norm, being perceived legitimate reduces stakeholder friction and can translate into valuation premia (Suchman, 1995; Islam et al., 2025).

In the absence of clear, mandatory reporting standards, the recent surge in ESG disclosure has created opportunities for greenwashing. Kathan et al. (2025) examine the relationship between ESG scores and greenwashing risk, and they find strong evidence: ESG scores primarily reflect apparent environmental performance (which is constructed from companies’ reports), while real environmental performance, based on quantifiable outcomes, correlates negatively with ESG scores (see Figure 3). It is also notable that in Figure 3, the apparent environmental performance turning point is in 2016, when previously mentioned Morningstar sustainability ratings were published.

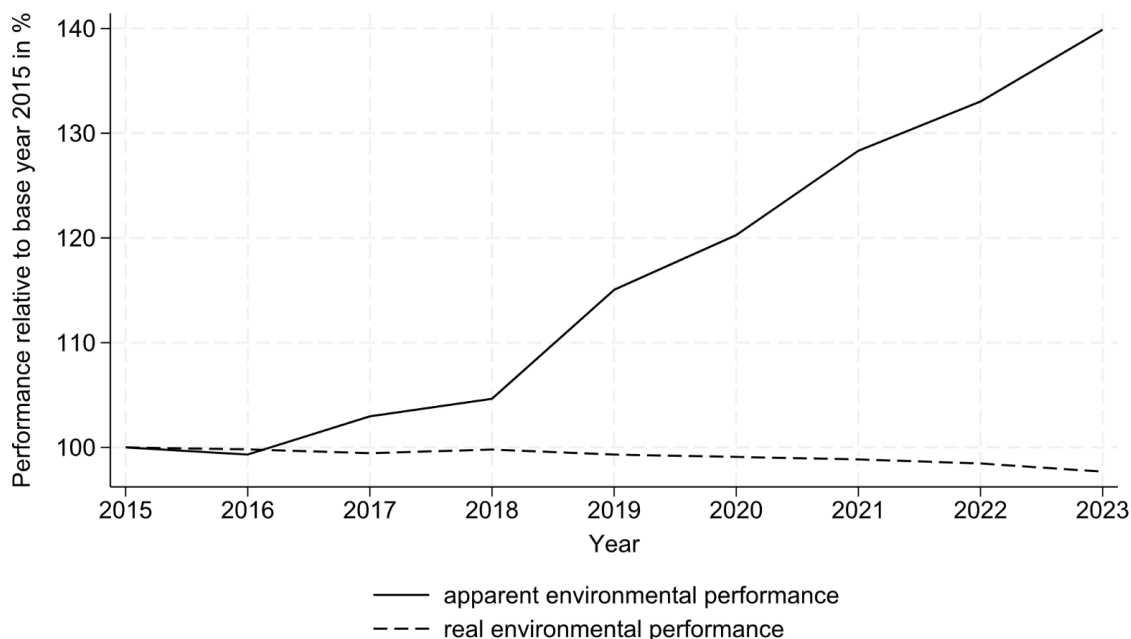


Figure 3. Development of sample companies' average apparent and real environmental performance over time (Kathan et al., 2025).

As previously stated, standards that are fragmented, inconsistent, and not sufficiently legislated enable greenwashing (Sulkowski & Jebe, 2022). Often in greenwashing, companies tend to have selective reporting, highlighting favorable metrics while knowingly leaving certain parts out of it to ensure the best possible ESG score/rating. In addition, when the reporting standards are partially voluntary, it leaves companies to decide which parts they will report (Sulkowski & Jebe, 2022). According to Foley et al. (2024) the claims regarding sustainability are often either deceptive, exaggerated, or false, and firms are setting overly ambitious goals without accounting for the full value chain. Heath et al. (2023) find that SRI (Socially Responsible Investment) funds primarily screen for already high-rated firms. This improves the portfolio's ESG score and marketing appeal, but leaves little room for improvement, which weakens the funds' ability to cause change in corporate behavior, as they have promised. In short, SRI funds are effective at stock picking, but because they tilt toward already compliant firms, they are relatively weak in bringing about significant changes in corporate practices (Heath et al., 2023).

In summary, these theoretical frameworks provide complementary perspectives on the ESG-CFP relationship. Stakeholder theory predicts a positive causal effect from ESG to CFP, agency theory warns of reverse causality driven by managerial motives, and legitimacy theory captures the social dynamics that can produce both genuine and symbolic ESG engagement. Together, they establish the foundation for evaluating whether high ESG performance is primarily a cause or consequence of firm success.

2.6 Measures of Corporate Performance

This sub chapter explains the methods used for measuring corporate performance and value.

Tobin's Q is a fundamental concept in finance and economics used as a measure of firm valuation and investment opportunities. It is often viewed as a forward-looking indicator that captures the market's perception of a firm's growth potential, management effectiveness, and overall value generation capacity (Buchanan et al., 2018; Servaes & Tamayo, 2013; Vaihekoski & Yahya, 2023). While the calculation methods vary slightly between studies, the commonly used method is ratio of market value of the firm's assets to the book value of its assets. Studies often examine whether high ESG performance or CSP correlates positively with Tobin's Q, suggesting that these activities are value-enhancing (Gillan et al., 2021).

Equation 1. Tobin's Q (Islam et al., 2025).

$$Tobin's\ Q = \frac{Market\ Value\ of\ Assets}{Book\ Value\ of\ Assets}. \quad (1)$$

Return on Assets (ROA) is an accounting-based measure that reflects how efficiently a company uses its assets to generate profit, and unlike Tobin's Q, ROA provides a backward-looking assessment of current-period performance (Vaihekoski & Yahya, 2023; Flammer, 2015). ROA is typically defined as the ratio of a company's net income (or

operating income before depreciation/interest and taxes) to its total assets (or average total assets) (Vaihekoski & Yahya, 2023; Flammer, 2015; Candio, 2024).

Equation 2. Return on Assets (ROA).

$$ROA = \frac{\text{Net Income (or Operating Income)}}{\text{Total Assets}}. \quad (2)$$

3 Literature Review

The relationship between Environmental, Social, and Governance (ESG) performance and corporate financial performance (CFP) has been one of the most intensely debated topics in finance over the past two decades. The surge in ESG interest, fueled by regulatory shifts, investor demand, and societal pressures, has produced a large body of research. Yet, despite the volume of studies, the field remains fragmented, with mixed results and diverging theoretical interpretations.

According to Gillan et al. (2021) many studies find a non-negative relationship between ESG and corporate financial performance (CFP), and most of them find a positive relationship. There are also certain conditions under which a positive relationship has been found between ESG and CFP. Studies show that the firms exhibiting this positive relationship also tend to incur higher advertising expenses (Servaes & Tamayo, 2013; Albuquerque et al., 2018). ESG can also create value for corporations via risk reduction and differentiation. For example, Lins et al. (2017) find that firms with higher ESG ratings exhibited better stock performance and profitability during the 2008 financial crisis. Similarly, Albuquerque et al. (2018) provide evidence that ESG performance reduces a firms' systematic risk.

As previously stated, ESG/CSR initiatives do not always create value for corporations, and in certain circumstances, they might be a cost. An argument which appears in some studies is that ESG reporting may reflect agency problems in corporate governance. Krüger (2015) finds that investors respond strongly negatively to negative CSR news, but they also respond negatively to positive CSR news when it is interpreted as agency-motivated action. For example, managers using free cash flow to fund visible CSR projects that enhance their personal reputation, divert attention from weak operating performance, which might be a result of agency problems. Some studies find that CSR can lower returns, reduce profitability, or show no financial benefit. Di Giuli & Kostovetsky (2013) find that when companies expand their CSR policies, the long-term result is stock underperformance and deterioration in return on assets (ROA). Buchanan et al. (2018) find a

negative coefficient estimate between ESG measures, crisis indicators, and Tobin's Q, and show that during financial crises, ESG overinvestment caused bigger falls for companies with higher ESG scores.

To clarify this complex field, this literature review organizes prior work into three thematic channels: ESG as a driver of firm performance, ESG as a consequence of a firm's financial performance, and ESG as a market signal affecting firm valuation. Each stream is informed by core theories (Stakeholder, Agency, and Legitimacy) and provides distinct insights into the bidirectional nature of ESG's relationship with financial performance.

3.1 ESG as a Driver of Financial Performance

Stakeholder theory suggests that firms generate long-term value not only by serving shareholders, but by managing relationships with a broader set of stakeholders (customers, employees, suppliers, and communities). In this view, ESG practices improve operational efficiency, reduce frictional costs, enhance reputation, and attract loyal customers and investors.

Several empirical studies substantiate this perspective. By responding to stakeholders' interests, firms can build trust and legitimacy, leading to sustained financial performance (Martiny et al., 2024). According to Servaes & Tamayo (2013) the financial impact of ESG is strongest in industries or periods where customer awareness is high and firms actively communicate (advertise) their ESG achievements. Especially in consumer-facing industries, successful ESG-related engagements lead causally to better operational performance and lower downside risk (Dimson et al., 2015). Albuquerque et al. (2018) argue that CSR is associated with statistically and economically significant lower systematic risk (beta) and they show that one standard deviation increase in a firm's CSR score is linked to a beta that is 1 % lower relative to the sample mean.

Moreover, ESG has been shown to contribute to corporate resilience in times of crisis. Lins et al. (2017) document that during the global financial crisis, firms with higher social

capital outperformed peers by 4–8% in stock returns and had superior profitability and margins. These findings are echoed by Albuquerque et al. (2020) during the COVID-19 pandemic, further reinforcing ESG's role as a strategic asset under uncertainty.

Beyond crisis periods, ESG also enhances internal efficiency. Flammer (2015) demonstrates that firms adopting environmental practices experience productivity gains, which improve operating margins. Hartzmark & Sussman (2019) find that funds rated highly for ESG (Morningstar Sustainability ratings in 2016) attract large inflows, implying that ESG labels drive capital allocation, changing the cost of capital and indirectly affecting corporate performance (see Figure 4 below).

Several studies find that ESG tends to be a useful tool for mitigating different risks. In terms of regulatory risk, credible environmental and social practices lower exposure to fines, lawsuits, and compliance shocks, and climate-risk disclosure improves the information set of institutional investors (Ilhan et al., 2023; Krüger et al., 2020). There are also studies that find that investor demand for sustainable assets can lower the cost of capital (Hartzmark & Sussman, 2019; Pástor et al., 2021), which improves company's position with financial risks.

Overall, stakeholder theory, supported by evidence on customer, risk, and financing channels (Servaes & Tamayo, 2013; Dimson et al., 2015; Albuquerque et al., 2018; Lins et al., 2017; Hartzmark & Sussman, 2019), provides a compelling framework for ESG to cause better performance. However, the effect is conditional on stakeholder salience, disclosure credibility, and governance quality, and it competes with the resource-based reverse causality argument (Gillan et al., 2021). So, it is possible that financially strong firms may simply be better able to invest in ESG or CSR activities (Gillan et al., 2021) and this challenge directly motivates Hypothesis 1: testing whether the CFP of high-ESG firms are driven by ESG as a causal factor, or simply reflects the ability of well-performing firms to invest in stakeholder relations.

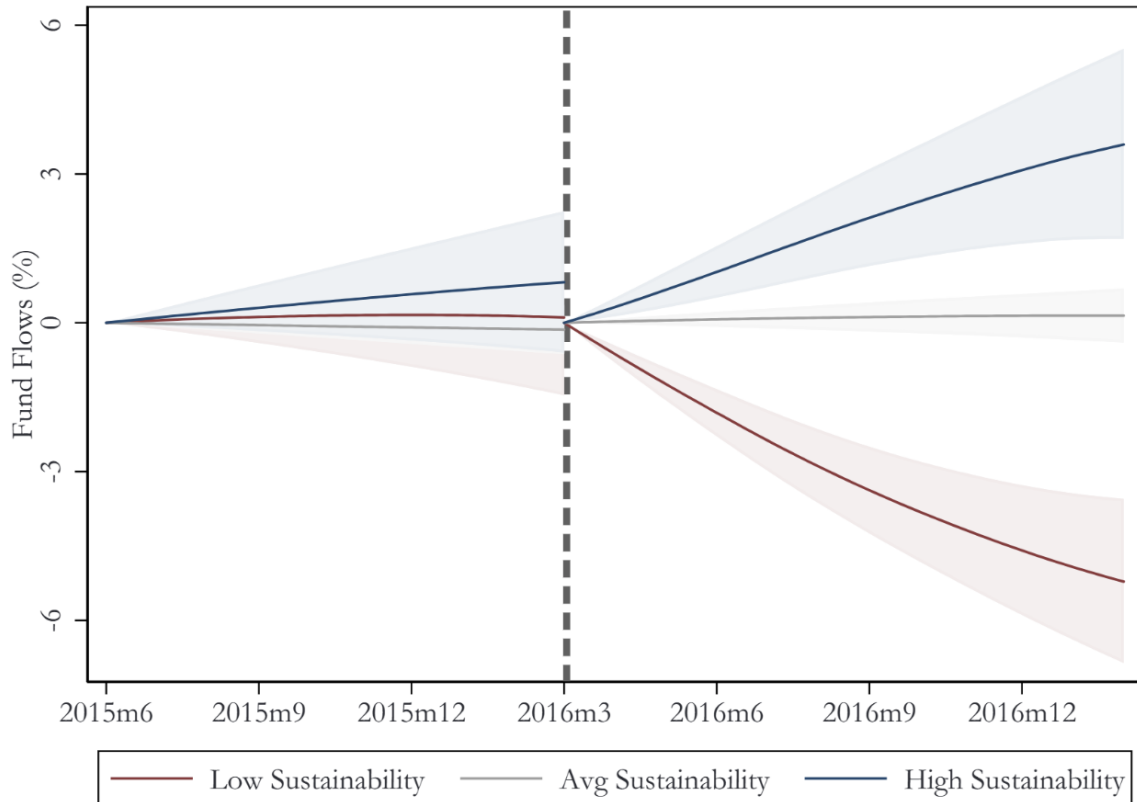


Figure 4. Cumulative fund flows by sustainability rating (Hartzmark & Sussman, 2019).

3.2 ESG as a Consequence of Financial Performance

A contrasting view suggests that ESG engagement is not an exogenous driver of performance, but rather an outcome of financial slack, managerial discretion, or strategic mimicry. This line of reasoning is grounded in agency theory (Jensen & Meckling, 1976). It conceptualizes the firm as a nexus of contracts in which managers (agents) may not always act fully in shareholders' (principals') interests, especially when legislation and oversight is weak or managers have more than enough resources to invest.

Krüger (2015) finds that positive CSR news may reflect managerial interests (e.g., reputation, insulation against criticism) rather than pure shareholder value, which is the goal that managers actions and decisions should pursue. He also finds that negative ESG events typically have a stronger and more lasting market impact than positive disclosures.

According to Bifulco et al. (2023), ESG expenditures and communications can serve as marketing or reputational instruments for managers rather than as economically justified investments. They also argue that ESG investments do not sufficiently improve corporate financial performance and may reduce shareholder value.

Empirical studies show that “doing well enables doing good” meaning that firms with strong corporate financial performance (CFP) are significantly more likely to increase their ESG spending, adopt sustainability initiatives, or disclose more on ESG performance (Hong et al., 2012; Ferrell et al., 2016). Hong et al. (2012) also verify that their theoretical modelling and empirical evidence demonstrate that less financially constrained firms spend more on “goodness” (ESG/CSR). CSR spending proves significantly more sensitive to the availability of financial slack than traditional capital expenditures or R&D spending, which supports also the resource availability channel (Hong et al., 2012). Several studies show that internal determinants like firm size, resource availability, and financial strength are among the strongest predictors of ESG performance (Martiny et al., 2024). They also mention that financial performance is a key internal determinant, and well managed resources are statistically associated with higher ESG performance.

While several studies show that ESG performance/CSP and corporate financial performance (CFP) have a positive correlation, the empirical literature still documents that less financially constrained, more profitable, larger firms are more likely to invest in and disclose ESG/CSR activities (Hong et al., 2012; Gillan et al., 2021; Vaihekoski & Yahya, 2023; Martiny et al., 2024). Also, some of the ESG expansion appears to be agency-driven, because positive CSR news in high-slack firms is received negatively by the market, and heavy CSR spending is associated with lower future stock returns (Krüger, 2015; Borghesi et al., 2014). Therefore, many firms that appear to be “ESG leaders” at a certain time may simply be the firms that were already financially strong performers, which directly motivates H1.

3.3 ESG and Market Valuation

The relationship between ESG performance and firm valuation is complex and context dependent. While some studies suggest a positive association, others highlight challenges in measurement and credibility that weaken ESG's signaling power. This section interprets ESG's influence on market valuation through the lens of legitimacy theory, particularly Suchman's (1995) typology, which helps explain why ESG signals may or may not be priced by investors.

Pragmatic legitimacy is granted when the audience (investors, customers) perceives a tangible benefit to themselves from the company's ESG activities, e.g. better cash flows or lower risk. Studies find that CSR increases Tobin's Q, particularly when customer awareness is high, because CSR works through stronger customer relationships and willingness to pay, which is a direct stakeholder benefit (Servaes & Tamayo, 2013; Gao & Zhang, 2015). Investors value ESG because it provides them with a clearer assessment of future performance and lower risk (Kräussl et al., 2023). For instance, studies show that high-ESG firms experience less downside risk (i.e., they are more resilient during market crashes) (Foley et al., 2024; Assaf et al., 2024; Gillan et al., 2021; Pástor et al., 2021). By contrast, weak environmental performance is associated with higher downside risk and higher option-implied protection costs, consistent with investors using ESG as a hedge against environmental tail risks (Ilhan et al., 2021).

Moral legitimacy rests on societal values and whether the firm is seen as "doing the right thing", which often transcends direct financial calculations (Suchman, 1995). Markets assign a valuation premium when a firm's commitment addresses high-salience risks, like climate change or human right issues (Janz et al., 2025). For example, as previously mentioned, the market reacts strongly negatively to negative CSR/ESG events, particularly those concerning communities and the environment, reflecting the perceived cost of social irresponsibility (Krüger, 2015). However, when Kathan et al. (2025) find that high-ESG scores often reflect "apparent" rather than "real" environmental performance (see Figure 3, p. 17), it should be interpreted as a collapse of moral legitimacy.

Cognitive legitimacy is the deepest form of legitimacy, where the organization's actions are simply assumed to be desirable or taken for granted as natural and inevitable (Suchman, 1995). As previously mentioned, Sulkowski & Jebe's (2022) study shows how multiple standard-setters and the EU's CSRD are gradually institutionalizing ESG disclosure, and over time this can make ESG reporting a default, "natural" element of corporate practice. Lins et al. (2017) find that high-CSR firms outperformed in the 2008-2009 crises and based on Suchman's (1995) typology, stakeholders already have a well-established "story" about these firms as trustworthy and community-oriented, making them seem more predictable and "natural" choices.

Gillan et al. (2021) show that empirical studies (e.g., Albuquerque et al., 2018; Hong & Kacperczyk, 2009) find that better ESG performance and disclosure are generally associated with lower cost of equity and debt, especially when investor protections and ESG norms are strong. For instance, ESG disclosure has been found to reduce cost of capital and increase firm value in European markets (Gillan et al., 2021). After the EU's sustainability labelling funds that were credibly labelled as more sustainable both improved their ESG scores and attracted larger net inflows, indicating that transparent and regulated ESG labels affect investor demand and market valuation indirectly (Becker et al., 2022). Hartzmark & Sussman (2019) show the exact same phenomenon in their study, after Morningstar released their sustainability scores in 2016 (see Figure 4, p. 23).

ESG increasing market valuation depends highly on context and credibility conditions. ESG appears especially value relevant in sectors with high environmental (E) and social (S) exposure (e.g., consumer facing, brand-driven or natural resource industries) where stakeholder and regulatory scrutiny is stronger and ESG can meaningfully reduce risk (Gillan et al., 2021; Dimson et al., 2015). Investor sustainability preferences shape the effectiveness of ESG on market valuation. Pástor et al. (2021) show that the size of the ESG industry and the ESG price premium depend on how many investors have strong ESG taste. They find that when ESG-motivated investors dominate, green firms enjoy

higher prices and lower costs of capital. There is also evidence suggesting that a sizable subset of institutional and retail investors is willing to sacrifice financial returns for ESG or climate hedging motives (Kräussl et al., 2023; Giglio et al., 2025), which supports higher share prices for high-ESG performing companies. Many U.S. retail investors expect ESG to underperform on average, but a meaningful subset still allocate more to ESG funds, which indicates that non-financial fundamentals and mitigating risks drive valuations (Giglio et al., 2025).

There is robust evidence that ESG can increase market valuation by enhancing customer loyalty and differentiation, building social capital and trust that improve crisis resilience, reducing downside and climate-related risk, and firms' cost of capital (Gillan et al., 2021; Kräussl et al., 2023). However, these valuation effects are not uniform: valuation gains are stronger in industries with high environmental or social exposure and when investor sustainability preferences are salient. Taken together, these patterns partly support H2 : ESG tends to enhance market valuation, especially when disclosure is credible.

3.4 Greenwashing, Measurement Problems & ESG Rating Disagreement

A central finding across recent ESG research is that ESG scores often capture what firms communicate (advertise), not what they actually do. This divergence between apparent and real environmental performance (see Figure 3, p. 17) directly undermines the legitimacy foundations that underpin H2's valuation argument. As previously mentioned, apparent performance (disclosure) consists of environmental claims, targets, and sustainability reporting, which often are self-reported and unaudited when taken into account by rating agencies (Kathan et al., 2025). This has created a mix of standard-setters, causing confusion and dissatisfaction for both reporting companies and information users (e.g., investors) (Sulkowski & Jebe, 2022).

The real performance (outcomes) is the actual environmental impact, measurable emissions reductions, pollution incidents, and quantifiable resource use, which are harder to observe and less central to ESG scoring methods (Kathan et al., 2025). The complexity

arises because of ESG reporting governance is institutionally dense and fragmented, preventing uniformity in metrics (Sulkowski & Jebe, 2022). This connects to the legitimacy theory, when firms prioritize symbolic communication (apparent performance) over substantive change (real performance) (Kathan et al., 2025), gaining moral legitimacy. Suchman (1995) warns that such strategies could risk firm's credibility, and once stakeholders recognize the disconnect, the moral basis for legitimacy collapses (Islam et al., 2025).

Empirical research reveals that large companies with the highest ESG ratings contain the most greenwashing cases (Kathan et al., 2025). They also find a positive correlation between ESG score and greenwashing risk. From the moral legitimacy perspective: greenwashing is a fundamental failure. When stakeholders discover that a firm's sustainability claims are false, the ethical foundation for support dissolves and the firm no longer appears to be "doing the right thing" (Kathan et al., 2025; Islam et al., 2025). From the pragmatic legitimacy view, even if a firm's greenwashing could fool investors, the deception reverses support, and investors lose confidence in the firm's self-reported data and management (Li et al., 2022). Some high-profile greenwashing cases have undermined cognitive legitimacy via creating a taken-for-grantedness of scepticism rather than trust (Foley et al., 2024). The firm becomes cognitively associated with deception, making it harder for investors to view ESG claims as reliable or predictable (Islam et al., 2025).

Beyond greenwashing, the structural fragmentation of ESG measurement itself weakens legitimacy. Studies show that there is low correlation between ESG rating providers (MSCI, Refinitiv, Bloomberg, Sustainalytics, etc.), which means there are different ESG ratings for the same company, and two investors using different data sources could result in opposite conclusions (Kathan et al., 2025; Martiny et al., 2024). Sulkowski & Jebe (2022) argue that the focus should be on the quality of disclosure, not the quantity of it, and that ESG reporting suffers from a lack of standardized metrics. Suchman (1995) emphasizes that cognitive legitimacy requires that audiences can comprehend the organization's logic and predicts its behavior. When multiple rating systems produce conflicting signals, investors cannot form a coherent mental model of what "good" ESG score

actually means (Sulkowski & Jebe, 2022) and this fragmentation undermines cognitive legitimacy.

ESG disclosure is increasingly mandatory in some jurisdictions (EU, UK) but remains fragmented and often driven by symbolic compliance rather than substantive change (Martiny et al., 2024). The EU's Non-Financial Reporting Directive (NFRD) pushes ESG disclosure, but studies find that disclosure improvements do not automatically translate into real ESG improvements (Martiny et al., 2024). Lueg & Pesheva (2021) find that in Nordic markets, excessive ESG disclosure relative to substance is associated with lower shareholder returns, and Sulkowski & Jebe (2022) also state that: "Reporting companies complain of the "reporting treadmill" where they spend more time gathering and reporting data than improving their operations".

These measurement problems, and especially greenwashing risks, directly support H2. Based on Kathan et al.'s (2025) study, when credibility weakens, valuation effects disappear or are reversed. They show that apparent ESG performance can mask real environmental performance degradation, which is precisely the kind of information failure that undoes valuation premiums once stakeholders discover it. The push toward harmonized and mandatory ESG disclosure is an attempt to rebuild cognitive and pragmatic legitimacy, reduce rating disagreement, and enforce substantive disclosure standards (Sulkowski & Jebe, 2022). Without such standardization, ESG ratings remain fragile signals, vulnerable to scepticism and revision. The credibility of ESG disclosures is essential not only for firm-level valuation but also for sustaining trust in the ESG ecosystem. The ESG valuation premium is strongest when: disclosure is transparent and externally audited, firms operate in a high-salience industry where greenwashing is easier to detect, and analyst coverage and media scrutiny are strong.

4 Practical Implications and Suggestions for Future Research

This chapter translates the thesis' main ideas into actions for corporate decision-makers and capital providers/policymakers. It also clarifies how the evidence should be used in practise and where stronger identification is still required.

Corporate managers could treat ESG as a capital-allocation decision, not a slogan. They could build an ESG capital budget that competes with other projects on risk-adjusted NPV and require post-implementation reviews to distinguish symbolic spends from value-creating ones. Managers should make the company's outcomes as credible as they can by having e.g., external audit for ESG reporting, independent board committee for sustainability oversight, and obtaining limited or reasonable assurance of key metrics. Also, managers should manage greenwashing risk explicitly by adopting an internal greenwashing risk register and by linking ESG to financing terms while avoiding targets that invite penalties or reputational risks.

For investors, it is crucial to separate cause from consequence during diligence. They should examine pre-investment profitability and free cash flow trends relative to ESG adoption. They should assess governance quality as a filter for value-creating vs managerial ESG and maintain a critical stance toward ESG score providers and the correlation between them.

There are indirect implications for standard setters and policymakers outlined earlier in this thesis. Legislation should encourage harmonized and auditable reporting to shrink rating disagreement that currently blurs the ESG-valuation link (H2). The standards and metrics of each ESG-score provider should be sufficiently consistent so that users do not reach substantially different conclusions when relying on different providers.

Future work should tighten causal identification and measurement. A priority is to separate substantive ESG performance from disclosure-driven signals. Studies could pair quasi-experiments (e.g., rating-methodology changes or external-assurance

requirements) with outcome data that are difficult to manage, such as measured emissions or supply-chain violations. Researchers could also combine third-party assurance and media sentiment into credibility indices that interact with ESG scores in returns, cash-flow, and cost of capital models. Finally, dynamic models should trace the dynamic loop between cash flows and ESG: when positive cash-flow shocks enable ESG investment (consequence channel), and when those investments later improve margins, resilience, or financing terms (cause channel).

5 Conclusion

The literature review reveals a complex and often contradictory landscape regarding the relationship between Environmental, Social, and Governance (ESG) performance and Corporate Financial Performance (CFP) or market valuation. While academic interest in this area is growing rapidly, several fundamental issues remain unresolved, providing the motivation and clear direction for this thesis. The findings across the reviewed studies reveal that ESG can function as both a driver and a consequence of corporate success, depending on the contextual and methodological lens.

Despite numerous empirical studies, a definitive, widely accepted causal link between ESG performance and financial outcomes remains elusive for several reasons. Most of the existing literature in this area shows a positive correlation between ESG performance and firm success (e.g., strong ESG firms tend to be larger and more profitable) (Martiny et al., 2024; Gillan et al., 2021; Vaihekoski & Yahya, 2023). However, existing correlation does not clarify whether ESG leads to financial success (“doing well by doing good”) or whether the financial success enables ESG spending (“doing good by doing well”) (Gillan et al., 2021; Vaihekoski & Yahya, 2023; Flammer, 2015). Studies using instrumental variables or regression discontinuity models to address endogeneity often produce mixed results or focus only on specific subsets of ESG activities, which limits their generalizability (Krüger, 2015; Flammer, 2015).

The literature frequently conflates the two distinct pathways proposed in this study’s framework: ESG as a consequence of prior financial strength (Agency/Resource view) versus ESG as a cause of superior future valuation (Legitimacy view). There is strong empirical evidence that financial slack and the easing of financial constraints enable firms to pursue greater corporate goodness (Gillan et al., 2021; Vaihekoski & Yahya, 2023; Ferrell et al., 2016). This supports the notion that ESG activity is often a selection effect, where already strong firms choose to engage. However, the exact mechanisms (agency costs vs. resource efficiency) are difficult to isolate and remain debated (Gillan et al., 2021; Vaihekoski & Yahya, 2023). Once the causal link between ESG and CFP is established, the

mechanism is usually linked to risk reduction, lower cost of capital, and enhanced social capital (Gillan et al., 2021). Yet, few studies explicitly and simultaneously model how the initial financial state (CFP → ESG) influences the subsequent valuation outcome (ESG → Valuation), which is necessary to understand the bi-directional nature of the relationship (Vaihekoski & Yahya, 2023).

The most significant and currently unresolved issue centres on the credibility of ESG signals, particularly the impact of disclosure quality on the valuation channel. The ESG reporting ecosystem is characterized by normative and institutional fragmentation, leading to confusion about standards and critical issues regarding the reliability and comparability of data (Sulkowski & Jebe, 2022). This fragmentation undermines the core assumption that investors can accurately interpret and rely on ESG scores for decision-making (Sulkowski & Jebe, 2022; Krüger, 2015; Assaf et al., 2024). Greenwashing creates a structural risk of deception, which means that positive valuation (H2) is perpetually conditional on the firm overcoming the trust deficit created by misleading metrics (Foley et al., 2024; Kathan et al., 2025). The systematic flaws in measurement, exemplified by high rating disagreement and the prevalence of greenwashing, constitute a triple failure of organizational legitimacy (pragmatic, moral and cognitive) (Sulkowski & Jebe, 2022; Kathan et al., 2025). While many studies acknowledge these limitations, few have integrated ESG credibility explicitly into their empirical frameworks or tested its moderating effects using rigorous identification strategies.

The vast body of ESG research remains fragmented and offers conflicting results, often based on methods that cannot conclusively separate causation from correlation (Gillan et al., 2021). Crucially, the prevailing uncertainty surrounding measurement quality and greenwashing undermines the validity of the ESG argument. This thesis addresses these gaps by conducting a structured literature review that maps the bi-directional causal frameworks linking ESG and corporate financial performance (CFP). It systematically distinguishes how prior studies treat ESG either as a consequence of resource availability (reverse causality) or as a potential causal driver of market valuation. It synthesizes

empirical evidence to assess the conditional nature of ESG-to-valuation link, specifically integrating objective measures of disclosure credibility and risk to determine the conditions under which the ESG premium is realized. This research moves beyond the “correlation versus causation” debate by modeling ESG activity as a dynamic loop: financial strength enables ESG choices, and the credibility of those choices determines their shareholder value payoff. It provides a nuanced understanding of when and how ESG truly creates shareholder value.

References

- Agoraki, M. K., Kouretas, G. P., Wu, H., & Zhao, B. (2025). Imbalanced ESG investing? *Journal of Corporate Finance*, 93, 102810. <https://doi.org/10.1016/j.icorpfm.2025.102810>
- Albuquerque, R., Koskinen, Y., & Zhang, C. (2018). Corporate social responsibility and firm risk: Theory and empirical evidence. *Management Science*, 65(10), 4451–4469. <https://doi.org/10.1287/mnsc.2018.3043>
- Albuquerque, R., Koskinen, Y., Yang, S., & Zhang, C. (2020). Resiliency of environmental and social stocks: An analysis of the exogenous COVID-19 market crash. *The Review of Corporate Finance Studies*, 9(3), 593–621. <https://doi.org/10.1093/rcfs/cfaa011>
- Assaf, C., Monne, J., Harriet, L., & Meunier, L. (2024). ESG investing: Does one score fit all investors' preferences? *Journal of Cleaner Production*, 443, 141094. <https://doi.org/10.1016/j.jclepro.2024.141094>
- Becker, M. G., Martin, F., & Walter, A. (2022). The power of ESG transparency: The effect of the new SFDR sustainability labels on mutual funds and individual investors. *Finance Research Letters*, 47, 102708. <https://doi.org/10.1016/j.frl.2022.102708>
- Bifulco, G. M., Savio, R., Paolone, F., & Tiscini, R. (2023). The CSR committee as moderator for the ESG score and market value. *Corporate Social Responsibility and Environmental Management*, 30(6), 3231–3241. <https://doi.org/10.1002/csr.2549>
- Borghesi, R., Houston, J. F., & Naranjo, A. (2014). Corporate socially responsible investments: CEO altruism, reputation, and shareholder interests. *Journal of Corporate Finance*, 26, 164–181. <https://doi.org/10.1016/j.icorpfm.2014.03.008>
- Buchanan, B., Cao, C. X., & Chen, C. (2018). Corporate social responsibility, firm value, and influential institutional ownership. *Journal of Corporate Finance*, 52, 73–95. <https://doi.org/10.1016/j.icorpfm.2018.07.004>
- Candio, P. (2024). The effect of ESG and CSR attitude on financial performance in Europe: A quantitative re-examination. *Journal of Environmental Management*, 354, 120390. <https://doi.org/10.1016/j.jenvman.2024.120390>
- Carroll, A. B. (1979). A three-dimensional conceptual model of corporate performance. *Academy of Management Review*, 4(4), 497–505. <https://doi.org/10.2307/257850>

- Di Giuli, A., & Kostovetsky, L. (2013). Are red or blue companies more likely to go green? Politics and corporate social responsibility. *Journal of Financial Economics*, 111(1), 158–180. <https://doi.org/10.1016/j.jfineco.2013.10.002>
- Dimson, E., Karakaş, O., & Li, X. (2015). Active ownership. *Review of Financial Studies*, 28(12), 3225–3268. <https://doi.org/10.1093/rfs/hhv044>
- Donaldson, T., & Preston, L. E. (1995). The stakeholder theory of the corporation: Concepts, evidence, and implications. *Academy of Management Review*, 20(1), 65–91. <https://doi.org/10.5465/amr.1995.9503271992>
- Ferrell, A., Liang, H., & Renneboog, L. (2016). Socially responsible firms. *Journal of Financial Economics*, 122(3), 585–606. <https://doi.org/10.1016/j.jfineco.2015.12.003>
- Flammer, C. (2015). Does corporate social responsibility lead to superior financial performance? A regression discontinuity approach. *Management Science*, 61(11), 2549–2568. <https://doi.org/10.1287/mnsc.2014.2038>
- Foley, A. M., Heffron, R. J., Kez, D. A., Rio, D. D. F. D., McInerney, C., & Welfle, A. (2024). Restoring trust in ESG investing through the adoption of just transition ethics. *Renewable and Sustainable Energy Reviews*, 199, 114557. <https://doi.org/10.1016/j.rser.2024.114557>
- Gao, L., & Zhang, J. H. (2015). Firms' earnings smoothing, corporate social responsibility, and valuation. *Journal of Corporate Finance*, 32, 108–127. <https://doi.org/10.1016/j.jcorpfin.2015.03.004>
- Giglio, S., Maggiori, M., Stroebel, J., Tan, Z., Utkus, S., & Xu, X. (2025). Four facts about ESG beliefs and investor portfolios. *Journal of Financial Economics*, 164, 103984. <https://doi.org/10.1016/j.jfineco.2024.103984>
- Gillan, S. L., Koch, A., & Starks, L. T. (2021). Firms and social responsibility: A review of ESG and CSR research in corporate finance. *Journal of Corporate Finance*, 66, 101889. <https://doi.org/10.1016/j.jcorpfin.2021.101889>
- Hartzmark, S. M., & Sussman, A. B. (2019). Do investors value sustainability? A natural experiment examining ranking and fund flows. *The Journal of Finance*, 74(6), 2789–2837. <https://doi.org/10.1111/jofi.12841>

- Heath, D., Macciocchi, D., Michaely, R., & Ringgenberg, M. C. (2023). *Does socially responsible investing change firm behavior? Review of Finance* (forthcoming). University of Miami Business School Research Paper No. 3837706; ECGI Finance Working Paper No. 762/2021. <https://doi.org/10.2139/ssrn.3837706>
- Hong, H., & Kacperczyk, M. (2009). The price of sin: The effects of social norms on markets. *Journal of Financial Economics*, 93(1), 15–36. <https://doi.org/10.1016/j.jfineco.2008.09.001>
- Hong, H. G., Kubik, J. D., & Scheinkman, J. A. (2012). *Financial constraints on corporate goodness* (NBER Working Paper No. 18476). SSRN. <https://ssrn.com/abstract=2164600>
- Ilhan, E., Krueger, P., Sautner, Z., & Starks, L. T. (2023). Climate risk disclosure and institutional investors. *The Review of Financial Studies*, 36(7), 2617–2650. <https://doi.org/10.1093/rfs/hhad002>
- Ilhan, E., Sautner, Z., & Vilkov, G. (2021). Carbon tail risk. *The Review of Financial Studies*, 34(3), 777–799. <https://doi.org/10.1093/rfs/hhaa071>
- Islam, T., Arunachalam, M., Wellalage, N., & Benjamin, S. (2025). Corporate environmental performance leading financial performance: Impacts of social media sentiment and corporate reputation. *Business Strategy and the Environment*, 34(4), 4274–4290. <https://doi.org/10.1002/bse.4201>
- Janz, C., Rilke, R. M., & Yurtoglu, B. B. (2025). Does ESG information impact individual investors' portfolio choices? *Journal of Economic Behavior & Organization*, 234, 107007. <https://doi.org/10.1016/j.jebo.2025.107007>
- Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), 305–360. [https://doi.org/10.1016/0304-405X\(76\)90026-X](https://doi.org/10.1016/0304-405X(76)90026-X)
- Kathan, M. C., Utz, S., Dorfleitner, G., Eckberg, J., & Chmel, L. (2025). What you see is not what you get: ESG scores and greenwashing risk. *Finance Research Letters*, 74, 106710. <https://doi.org/10.1016/j.frl.2024.106710>

- Krüger, P., Sautner, Z., & Starks, L. T. (2020). The importance of climate risks for institutional investors. *The Review of Financial Studies*, 33(3), 1067–1111. <https://doi.org/10.1093/rfs/hhz137>
- Krüger, P. (2015). Corporate goodness and shareholder wealth. *Journal of Financial Economics*, 115(2), 304–329. <https://doi.org/10.1016/j.jfineco.2014.09.008>
- Kräussl, R., Oladiran, T., & Stefanova, D. (2023). A review on ESG investing: Investors' expectations, beliefs and perceptions. *Journal of Economic Surveys*, 38(2), 476–502. <https://doi.org/10.1111/joes.12599>
- Li, W., Li, W., Seppänen, V., & Koivumäki, T. (2022). Effects of greenwashing on financial performance: Moderation through local environmental regulation and media coverage. *Business Strategy and the Environment*, 32(1), 820–841. <https://doi.org/10.1002/bse.3177>
- Lins, K. V., Servaes, H., & Tamayo, A. (2017). Social capital, trust, and firm performance: The value of corporate social responsibility during the financial crisis. *Journal of Finance*, 72(4), 1785–1824. <https://doi.org/10.1111/jofi.12505>
- Lueg, R., & Pesheva, R. (2021). Corporate sustainability in the Nordic countries – The curvilinear effects on shareholder returns. *Journal of Cleaner Production*, 315, 127962. <https://doi.org/10.1016/j.jclepro.2021.127962>
- Martiny, A., Tagliatalata, J., Testa, F., & Iraldo, F. (2024). Determinants of environmental social and governance (ESG) performance: A systematic literature review. *Journal of Cleaner Production*, 456, 142213. <https://doi.org/10.1016/j.jclepro.2024.142213>
- McWilliams, A., & Siegel, D. (2001). Corporate social responsibility: A theory of the firm perspective. *Academy of Management Review*, 26(1), 117–127. <https://doi.org/10.2307/259398>
- Mitchell, R. K., Agle, B. R., & Wood, D. J. (1997). Toward a theory of stakeholder identification and salience: Defining the principle of who and what really counts. *Academy of Management Review*, 22(4), 853–886. <https://doi.org/10.5465/amr.1997.9711022105>

- Morningstar, Inc. (2016). *Morningstar introduces industry's first sustainability rating for 20,000 funds globally, giving investors new way to evaluate investments based on environmental, social, and governance (ESG) factors*. Morningstar Newsroom. <https://newsroom.morningstar.com/newsroom/news-archive/press-release-details/2016/Morningstar-Introduces-Industrys-First-Sustainability-Rating-for-20000-Funds-Globally-Giving-Investors-New-Way-to-Evaluate-Investments-Based-on-Environmental-Social-and-Governance-ESG-Factors/default.aspx>
- Pástor, L., Stambaugh, R. F., & Taylor, L. A. (2021). Sustainable investing in equilibrium. *Journal of Financial Economics*, 142(2), 550–571. <https://doi.org/10.1016/j.jfineco.2020.12.011>
- Servaes, H., & Tamayo, A. (2013). The impact of corporate social responsibility on firm value: The role of customer awareness. *Management Science*, 59(5), 1045–1061. <https://doi.org/10.1287/mnsc.1120.1630>
- Suchman, M. C. (1995). Managing legitimacy: Strategic and institutional approaches. *Academy of Management Review*, 20(3), 571–610. <https://doi.org/10.2307/258788>
- Sulkowski, A., & Jebe, R. (2022). Evolving ESG reporting governance, regime theory, and proactive law: Predictions and strategies. *American Business Law Journal*, 59(3), 449–503. <https://doi.org/10.1111/ablj.12210>
- Zhang, N., Yang, C., & Wang, S. (2024). Research progress and prospect of environmental, social and governance: A systematic literature review and bibliometric analysis. *Journal of Cleaner Production*, 447, 141489. <https://doi.org/10.1016/j.jclepro.2024.141489>