Proceedings of ICMRED 2025 Symposium: Effective Communication as a Powerful Management Tool
DOI: 10.54254/2754-1169/2025.BL23675

# *Research on the Relationship Between ESG and Corporate Financial Performance*

**Muhang Zou**

*College of Letter and Science, University of Wisconsin-Madison, Madison, USA*
*priscillazmh@outlook.com*

***Abstract:*** In recent years, environmental, social, and governance (ESG) considerations have garnered more scrutiny from scholars, investors, and corporate executives. As ESG practices increasingly influence business activity and the way stakeholders evaluate long-term value, an encompassing question is: does ESG performance actually influence corporate financial performance (CFP)? This paper presents an exhaustive survey of recent scholarly research investigating the ESG–CFP nexus, integrating findings across current studies. The survey also discusses theoretical underpinnings such as stakeholder views, resource management concepts, and agency theory to describe the various ways ESG may affect financial outcomes. To the extent notable, variations across studies arise from differences across ESG dimensions, industry characteristics, governance structure, as well as research method choices. In aggregate, this review not only substantiates an aggregate positive association between ESG and financial performance, but indicates several less-worked-out observations: the asymmetry of ESG effects across ESG dimensions, the magnified influence of ESG at times of crisis, along with the value placed on depth of implementation and governance consonance over simplistic ESG scoring. These conclusions provide a more sophisticated view of how ESG operates as an ideational lever for corporate value generation.

***Keywords:*** Corporate, Financial Performance, ESG, Positive relationship

## 1. Introduction

Environmental, social, and governance (ESG) factors have become key considerations in corporate strategy and investment decisions, as stakeholders increasingly prioritize long-term sustainability. Reflecting this growing interest, Whelan et al. noted that over 1,000 academic studies on ESG and corporate financial outcomes were published between 2015 and 2020 [1]. The expanding volume of ESG-related reports and investment products underscores the topic's rising significance in financial markets.

A central question has emerged from this trend: does strong ESG performance improve a company's financial results? Theoretically, ESG may enhance reputation, reduce risk, and attract investment, contributing to profitability. However, ESG initiatives can also increase operational costs, especially in the short term, leading to debate over whether ESG investments are financially justified. Friede et al., in a meta-analysis of over 2,000 studies, found that about 90% reported a positive or neutral relationship between ESG and financial performance, suggesting that ESG may often create value—though its effectiveness likely varies by context [2].

© 2025 The Authors. This is an open access article distributed under the terms of the Creative Commons Attribution License 4.0 (https://creativecommons.org/licenses/by/4.0/).

DOI: 10.54254/2754-1169/2025.BL23675

Despite the rapid expansion of related research in recent years, academic studies examining connections between ESG factors and corporate financial outcomes continue to show mixed conclusions. Existing empirical research can roughly be divided into three categories. Some studies show positive correlations where sustainability strategies improve profitability [3,4]. Another set of studies argue there's no clear impact, or that results vary across different situations [5]. There's also research indicating nonlinear relationships—for instance, U-shaped curves where moderate ESG investments help but excessive spending leads to reduced returns [2,6].

In addition, the true effects may be moderated by contextual factors such as the industry the firm is from, size characteristics of the organization, and the policy backdrop at the nation-state level, among others. Variation across studies in data collection methods, measurement practices, and methods of analysis renders it difficult to compare across results, making it more challenging to make conclusive statements. Hence, it is crucial to synthesize existing research systematically.

The current paper presents an overview of some recent studies on the relationship between ESG performance and firm financial results. The review seeks to synthesize key results, observe areas of convergence and divergence, as well as identify gaps in existing studies. In particular, the review shall: (1) describe the primary mechanisms by which ESG influences financial performance; (2) compare results across countries, industries, and types of firms; (3) explore the influence of methodological differences as well as differences in measurements on conclusions; and (4) suggest avenues for future studies to enable more reliable and actionable results.

## 2. Theoretical background

### 2.1. Stakeholder theory

Stakeholder theory, introduced by Freeman in 1984, argues that companies should consider not just shareholders but also other groups like employees, customers, suppliers, governments, communities, and the environment. To put it simply, Whelan et al. highlight that strong ESG practices help build trust with stakeholders, which over time can lead to financial benefits [1]. For instance, maintaining high environmental standards reduces risks of accidents and fines, being socially responsible improves employee loyalty and productivity, and having transparent governance structures boosts investor confidence. Together, these factors contribute to better market performance and profitability in the long term.

### 2.2. Resource-Based View (RBV)

The resource-based perspective suggests that companies gain competitive advantages from resources that are unique and hard to copy. In the context of ESG, things like social responsibility strategies, environmental management capabilities, and governance transparency can act as "strategic resources." Studies, such as those by Chen et al. indicate that companies excelling in ESG tend to outperform peers financially, especially in high-risk sectors [4]. When firms integrate ESG into their core operations—transforming it into brand reputation, workforce advantages, or customer loyalty—they are more likely to achieve sustained profits. In other words, ESG should not be considered as a cost but as a driver of long-term value, giving leading companies an edge in market position and financial returns.

### 2.3. Agency theory

Agency theory is concerned with conflicts between managers (agents) and shareholders (principals). Strong ESG practices have the potential to align those interests by ensuring transparency and accountability. To illustrate, clear structures of governance minimize opportunistic action, and

DOI: 10.54254/2754-1169/2025.BL23675

environmental and social commitments establish stakeholder trust, lowering agency cost. By addressing those agency concerns, ESG activities contribute to stable financial performance and shareholder value over the long term.

Principal-agent theory observes the gaps in information and varying objectives between company owners and management teams. In the case of ESG affairs, some propose corporate executives may leverage ESG initiatives as 'ethics-driven projects' or 'reputation-building efforts' to raise corporate image, mostly for personal pride or media publicity at best without creating true economic value to the firm. That is to say, those efforts might be more about external perception than actual outcome. In addition, investments related to ESG considerations tend to have limited short-run financial gains and may be viewed as resource-consuming expenses that add to operating cost. In other words, such investments are short on delivering quick profitability but high on increasing budget pressures. As such, certain studies have questioned ESG's positive effects on organizational performance from an agency theory angle, especially where governing mechanisms are lacking or corporate governing institutions remain under-established. Under those scenarios, ESG activities may be present as signals of 'agency-related expenses' but not value-creating actions.

## 3. Current research progress

### 3.1. Positive effects of ESG on financial metrics

Empirical evidence shows that strong ESG performance is capable of building brand reputation, deepening stakeholder relationships, and enhancing risk management skills. As an example, organizations that receive high ESG scores can enjoy higher investor confidence as well as customer retention, thus indirectly leading to financial results. ESG-focused organizations are even seen to be better adaptable to changes in regulations and market dynamics, thus better placed for competitiveness over the long term. The evidence points to ESG integration, if done genuinely, acting as an asset for strategy and not only as a compliance requirement.

Most research studies indicate that strong ESG performance tends to positively influence company financial outcomes. Chen and colleagues, using data from thousands of companies worldwide, found that higher ESG scores generally correlate with improved profitability and stock market performance, with this effect being stronger in industries facing greater risks and larger corporations [4]. They observed that ESG practices help reduce information gaps, build corporate reputation, and attract investors focused on long-term gains. Similarly, Ahmad et al., analyzing UK-based FTSE350 firms, discovered positive relationships between composite ESG scores and financial metrics, particularly in the social responsibility and governance dimensions [1]. Aydoğmuş and team, examining İstanbul Stock Exchange data, further noted that ESG not only boosts market valuation metrics but also improves profitability indicators like return on assets [5].

Additionally, research by Gao and others [6] on Chinese companies during pandemic conditions suggested that robust ESG performance assists firms in managing market instability while increasing their value and earnings per share. Wawers' European study similarly found that companies with elevated ESG scores demonstrated greater financial and market stability during the COVID-19 crisis, indicating a "buffer effect" against external shocks [7]. Collectively, these findings imply that ESG adoption may not only enhance profitability but also strengthen organizational resilience during economic turbulence or unexpected events, providing what could be termed a "protective layer" for businesses.

### 3.2. Neutral or mixed effects of ESG on financial performance

Whereas several studies support ESG's positive effects, other studies suggest its effect on bottom-line results is situation-dependent or has limited effect. Some analyses find ESG programs have only

DOI: 10.54254/2754-1169/2025.BL23675

slower effects, implying that they may not have significant financial returns early on. Other studies suggest ESG investments may increase operational costs, especially where environmental factors have significant investments with extended payback durations.

The research by Aydoğmuş et al. demonstrates that while social and governance scores notably enhance company value, environmental scores show no clear link to market valuation [5]. This means that different parts of ESG can affect finances in different ways, so companies that follow ESG strategies without considering their specific industry might waste resources.

Regarding factors influencing ESG's effects, existing studies identify multiple variables that shape outcomes. For instance, Nekhili et al., examining French firms, found that the composition of employee representatives on boards alters how ESG relates to market value [8]. When representatives have shareholder affiliations, ESG strategies tend to be implemented more effectively, yielding stronger market returns. Conversely, representatives focused on labor rights correlate with ESG efforts concentrated on social aspects, which show weaker market impacts.

Additionally, factors like company size, industry type, national policies, and investor demographics significantly affect how ESG functions. Studies by Wawers and Gao et al. highlight that during crises—the COVID-19 pandemic being one example—ESG's positive role becomes more pronounced, acting as a kind of "buffer mechanism" to stabilize performance [7,4]. This underscores its potential as a flexible tool for navigating uncertainties, though its effectiveness depends on contextual variables.

Putting it all together, the effectiveness of ESG cannot be answered with a simple "yes or no" but rather presents a complicated matter shaped by multiple influences including industry types, geographical locations, and how organizations are structured.

## 4. Non-negative effects of ESG on financial performance from large-scale reviews

In addition to individual research articles, some have attempted to explore the relationship between ESG and firm performance through large-scale reviews or meta-analyses. The value of this is to aggregate results from multiple studies to establish more solid foundations for understanding overall patterns and consensus.

Friede, Busch & Bassen conducted a comprehensive analysis covering more than 2,200 studies published from 1970 to 2014, representing one of the most thorough examinations in this area [2]. Their work revealed that approximately 90% of studies indicated a "non-negative" link—that is to say, not harmful—between ESG and financial outcomes, with many showing positive correlations. These positive connections were especially noticeable in developed regions like the United States or countries in Western Europe. Furthermore, conclusions remained consistent across different research methods, such as statistical models, case studies, and surveys. At the investment level, ESG strategies frequently delivered better returns than expected. This study offers broad evidence that ESG adds value to businesses, suggesting it serves not only ethical goals but also economic benefits.

Whelan and colleagues built upon earlier work by analyzing studies from the previous five years, identifying new patterns in how ESG factors interact with financial performance [1]. Their review highlighted evolving methodologies and regional variations, reinforcing the idea that ESG's impact remains context-dependent while underscoring its growing relevance in corporate decision-making processes.

In light of the increasing attention to ESG research in recent years, Whelan and colleagues from New York University's Stern School of Business looked at more than 1,000 studies published from 2015 to 2020 [1]. They divided these into two main groups—company-focused and investment-focused—and found some important patterns. Specifically, over half of the company-level studies suggested ESG factors had positive links to financial performance, while a small portion showed negative connections, with others being inconclusive or mixed. The benefits

DOI: 10.54254/2754-1169/2025.BL23675

appeared stronger for companies held for longer periods and those operating in industries closely related to their ESG activities. When it comes to investments, the findings varied more widely, depending on different factors like types of investments (active versus passive strategies) and asset categories (stocks versus bonds), to name a few examples. The study highlights that ESG efforts need to align closely with a company's core business factors—that is to say, addressing issues that truly matter to their operations—while also relying heavily on transparent data reporting and consistent evaluation methods.

These comprehensive reviews indicate that, despite variations across different contexts, there is some convergence supported by evidence that ESG has an overall positive influence on the financial outcome of companies once the overall context is considered. The research further indicates that future studies ought to emphasize closer consideration of the timing aspects of ESG effects, industry-related traits, as well as more transparent channels through which ESG generates value—issues that may make it easier to understand the extent to which ESG is responsible for business success.

As for some of the current debate and comparison, although the bulk of research indicates ESG to be positively influencing, there still remain significant disagreements across studies. The reasons for the disagreements range from variance in research targets and time horizons to methodological decisions, ESG rating sources, as well as the particular financial metrics where analysis is tailored. In short, key areas of disagreement can be consolidated into three broad angles of discussion.

## 5. Discussion

### 5.1. Differences in research approaches and data origins

Numerous empirical studies utilize ESG metrics obtained from various databases, though notable variations exist in how different rating agencies approach ESG dimensions [1,2]. These differences manifest in three main aspects: how they define the dimensions, the setting of weights, and scoring mechanisms, which naturally lead to incomparable outcomes. To put it simply, identical companies might show completely different ESG evaluations depending on the rating agency used.

In addition, analytical method selection has the major influence on research conclusions. Basic data analysis tends to find simple correlations, while the use of sophisticated matching designs or event studies is able to expose underlying causal connections more effectively. Of course, some studies lack sufficient controls over confounding variables, distorting observed financial effects of ESG efforts.

### 5.2. Varied effects across ESG components

As a composite measure, the environmental, social, and governance components operate differently within corporate ecosystems. Research indicates that improvements in social responsibility and management structures more directly contribute to financial gains, while environmental investments often face challenges like high upfront costs and delayed returns [3,5]. For instance, certain studies have observed strong positive relationships between social/good governance factors and profit margins, whereas environmental scores showed minimal impact on company valuations. This suggests organizations should prioritize dimension-specific strategies aligned with their industry context rather than pursuing blanket high scores.

### 5.3. Tension between immediate results and sustained value

While ESG investments typically yield benefits over extended periods, most analyses rely on short-term financial metrics like quarterly reports. This methodological focus risks undervaluing

DOI: 10.54254/2754-1169/2025.BL23675

ESG's long-term advantages, particularly its gradual effects on brand equity, workforce retention, and risk mitigation capabilities. That is to say, the true worth of ESG strategies often becomes apparent through cumulative changes that standard financial indicators fail to capture immediately. For example, Whelan and colleagues note that the financial benefits of ESG can only be realized when companies adopt it as a long-term approach and align it with what matters most in their industry, that is to say, the so-called "material issues" [1]. Additionally, ESG tends to act as a protective shield during periods of high market uncertainty—for instance, what happened during the COVID-19 outbreak—a "context-dependent" effect often missed in traditional statistical studies.

In short, whereas recent research is largely consistent in asserting that ESG has a positive influence on the financial performance of companies, there is still significant disagreement over aspects such as the nature of studies, the selection of indicators, and contextualizing across different settings. These reflect the different ways that ESG works as an indirect, multi-faceted strategic tool. The future research has to address the issue of standardizing data, enhancing the methodological process of establishing cause-and-effect, as well as giving more prominence to long-term effects and industry variations, so as to bridge the theory-practice gap.

## 6. Conclusion

This paper examines closely the recent research investigating the relationship between ESG performance and corporate financial performance. In aggregate, current research is generally consistent with the notion that ESG has a positive influence, particularly in times of market turbulence or where stronger corporate governance systems exist. Theoretically, stakeholder theory and resource-based perspectives—i.e., that firms are reliant on varied resources—both posit ESG as a long-run strategic resource. Empirically, across regions, there has been broad evidence that ESG contributes to higher profits, enhanced company valuations, and mitigation of large-scale risk. But some studies identify that different ESG dimensions operate through different channels, and their financial effects may be emergent over extended timescales while depending on factors such as governance, industry, and data origins.

In summary, ESG cannot be viewed as a cost or branding exercise but as an advanced strategic initiative. Its financial performance is influenced by the depth to which it is embedded, priorities given to certain aspects, company characteristics, and external factors. In other words, the success of ESG is not one-size-fits-all but influenced by some combination of internal decisions and external drivers.

To companies, ESG initiatives cannot be left to mere formal disclosure or rating chasing but must be aligned with significant industry challenges. By integrating ESG principles into primary business functions, supply chain management, and employee incentive systems, that is to say, organizations can be both sustainable and profitable at the same time. To investors, ESG is an essential factor for assessing the long-run value potential of companies as well as risk management skills. The prominence of ESG factors in investment considerations can only increase over the passage of time, particularly against the backdrop of changing policy and increasing macroeconomic uncertainties.

Although there is available research to provide useful insights into the relationship between ESG and corporate performance, there are several areas of room for development and exploration. Potential future research could gain more understanding of this relationship through these methods: Further research requires better methodology, such as the use of certain analytical tools and experimental designs, to detect actual cause-and-effect relationships between ESG metrics and financial results. Existing studies use largely snapshot data, but future research must measure changes over time with longitudinal datasets or case studies to demonstrate the evolution of ESG strategies. Further research is required exploring varying ESG metrics (environment, social, and governance) impacting different financial metrics such as share performance, cash flow trends, and debt levels

differently. Broader development of the research to encompass small-to-medium-sized companies, emerging nations, and industry types such as green manufacturing would offer more comprehensive understanding. In short, simplifying inconsistency among ESG rating systems by way of standardized reporting frameworks would make data more reliable, as well as more comparable across studies.

## References

*[1] Whelan, Tensie, et al. ESG and FINANCIAL PERFORMANCE: Uncovering the Relationship by Aggregating Evidence from 1,000 plus Studies. 2015.*

*[2] Friede, Gunnar, et al. "ESG and Financial Performance: Aggregated Evidence from More than 2000 Empiri cal Studies." Journal of Sustainable Finance & Investment, vol. 5, no. 4, 2 Oct. 2015, pp. 210–233, https://doi.org/10.1080/20430795.2015.1118917. Accessed 31 Mar. 2025.*

*[3] Ahmad, Nisar, et al. "Revisiting the Impact of ESG on Financial Performance of FTSE350 UK Firms: Static and Dynamic Panel Data Analysis." Cogent Business & Management, vol. 8, no. 1, 1 Jan. 2021, https://doi.org/10.1080/23311975.2021.1900500. Accessed 31 Mar. 2025.*

*[4] Chen, Simin, et al. "Environmental, Social, and Governance (ESG) Performance and Financial Outcomes: Analyzing the Impact of ESG on Financial Performance." Journal of Environmental Management, vol. 345, Nov. 2023, p. 118829, https://doi.org/10.1016/j.jenvman.2023.118829. Accessed 31 Mar. 2025.*

*[5] Aydoğmuş, Mahmut, et al. "Impact of ESG Performance on Firm Value and Profitability." Borsa Istanbul Review, vol. 22, Dec. 2022, pp. S119–S127, https://doi.org/10.1016/j.bir.2022.11.006. Accessed 31 Mar. 2025.*

*[6] Gao, Weizhen, et al. "Analysis of the Impact of ESG on Corporate Financial Performance under the Epidemic Based on Static and Dynamic Panel Data." Wireless Communications and Mobile Computing, vol. 2022, 1 Sept. 2022, pp. 1–12, https://doi.org/10.1155/2022/6851518. Accessed 31 Mar. 2025.*

*[7] Wawers, Arne. An Analysis of the Impact of ESG on Corporate Financial Performance in Europe. Master's Thesis, Nova School of Business and Economics, 2021.*

*[8] Nekhili, Mehdi, et al. "The ESG–Financial Performance Relationship: Does the Type of Employee Board Representation Matter?" Corporate Governance: An International Review, vol. 29, no. 2, 14 Oct. 2020, pp. 134–161, https://doi.org/10.1111/corg.12345. Accessed 31 Mar. 2025.*