

When CSR/ESG Pays — and When It Doesn't

*Risk Mitigation, Materiality, and the
Governance Conditions for Financial Performance*

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Abstract

Debate over corporate social responsibility (CSR) and environmental, social, and governance (ESG) investing has often been framed in binary terms: either as a source of systematic outperformance or as a distraction from fiduciary duty. This paper evaluates the empirical literature and reframes the discussion through a governance lens. The evidence does not support universal claims of excess returns. Instead, it suggests that financial effects are conditional and arise through identifiable mechanisms, most consistently through downside risk mitigation. Financial relevance depends on economic materiality — meaning whether an ESG issue is structurally linked to a firm's financial outcomes through revenue, cost, regulatory exposure, or competitive positioning — governance integration, and horizon alignment. By synthesizing meta-analytic research, ratings disagreement studies, event-based evidence, and materiality-focused findings, the paper proposes a structured framework for boards and investment committees. Rather than advocating or dismissing ESG, it positions stakeholder governance as a conditional component of disciplined capital allocation.

Keywords: corporate social responsibility (CSR); environmental, social, and governance (ESG) investing; financial performance; risk mitigation; economic materiality; corporate governance; fiduciary duty; institutional capital; capital allocation; downside risk.

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1. Introduction — Reframing the Question

Corporate social responsibility (CSR) and environmental, social, and governance (ESG) investing are now embedded in mainstream capital markets. Yet debate persists over whether stakeholder-oriented practices meaningfully influence financial performance. This paper evaluates the empirical evidence and reframes the discussion through a governance lens, focusing on risk, materiality, and institutional conditions.

1.1 The polarized debate

Debate surrounding CSR and ESG investing has become increasingly polarized. Advocates often frame ESG as essential to long-term value creation, while critics argue that it dilutes fiduciary focus and introduces political or ideological considerations into capital allocation. This polarization hides the more fundamental institutional question: under what conditions do stakeholder-oriented practices affect financial outcomes?

In institutional capital settings — including endowments, insurance companies, pensions, hedge funds, private equity, and infrastructure investing — ESG discussions often oscillate between branding narratives and return skepticism. What is missing is a disciplined examination of mechanism: the specific pathway through which stakeholder practices may influence financial outcomes — through risk reduction, cost changes, or competitive positioning.

For fiduciaries, the relevant issue is not whether ESG aligns with values, but whether it materially influences risk exposure, cash-flow durability, or cost of capital. Framing the debate as binary — ESG either "works" or it "does not" — mischaracterizes the underlying economics. The empirical literature supports conditional effects rather than universal claims. This paper therefore avoids ideological positioning and instead evaluates the evidence through a governance lens.

1.2 Why "does ESG generate alpha?" is the wrong question

The question most frequently posed in capital markets — "Does ESG generate alpha?" — is narrowly framed. Alpha refers to risk-adjusted outperformance relative to a benchmark. Yet fiduciary responsibility extends beyond short-term excess return.

Boards and investment committees are charged with preserving capital, managing risk, and supporting durable value creation. Many ESG mechanisms operate through risk mitigation rather than systematic outperformance. Environmental compliance systems, safety protocols, supply chain oversight, and governance controls reduce the probability or severity of adverse events. These mechanisms are better understood as modifications to downside risk than as return enhancers.

In more return-maximizing strategies — such as hedge funds or private equity — ESG considerations are often incorporated opportunistically. If stakeholder practices improve

competitive positioning or reduce identifiable risk, they are adopted; if not, they are deprioritized. This reflects economic discipline rather than ideological inconsistency.

Reframing the question shifts the lens from "Does ESG outperform?" to "Through what economic mechanisms might stakeholder practices influence volatility, tail risk, or long-duration cash flows?" That reframing aligns with fiduciary duty.

1.3 Reframing as risk, materiality, and governance

To evaluate CSR/ESG rigorously, three dimensions are necessary. First, risk exposure: does the issue alter the firm's probability distribution of outcomes? Second, economic materiality: is the issue structurally linked to the firm's industry-specific financial drivers — its revenue sources, regulatory exposure, cost structure, or capital intensity? Third, governance integration: is the risk embedded in oversight and operational systems?

In institutional practice, ESG discussions frequently fail at the economic materiality stage. Boards may review environmental, social, and governance categories generically, without mapping them to asset-level or industry-specific economic exposure. Climate risk, for example, is often discussed at a reputational or portfolio level rather than analyzed asset-by-asset in underwriting models. Without economic linkage and operational integration, stakeholder initiatives risk becoming public statements rather than operational risk controls.

1.4 Positioning Within the Literature

The academic and practitioner literature on CSR and ESG broadly falls into three strands. The first examines the relationship between corporate social performance and financial outcomes, often through large-sample empirical studies and meta-analyses that report modest but heterogeneous associations. The second focuses on measurement challenges, including disagreement across ESG ratings providers and the implications of aggregation and methodological variation. The third examines specific mechanisms, including risk mitigation, stakeholder relationships, and the role of economically material ESG factors.

While this literature provides important insights, it often evaluates ESG either as an aggregate factor or as a source of potential outperformance. Less attention has been given to how governance structures, economic materiality, and institutional context jointly determine whether financial effects are realized.

This paper builds on these strands by synthesizing existing evidence and reframing ESG through a governance lens. Rather than asking whether ESG “works” in aggregate, this paper examines the conditions under which stakeholder practices influence financial outcomes and how those effects are shaped by institutional decision-making.

1.5 Research Question and Contribution

This paper examines under what conditions corporate social responsibility (CSR) and environmental, social, and governance (ESG) practices influence financial performance, and

through which economic channels these effects arise. Rather than treating ESG as a uniform factor, it evaluates how risk mitigation, economic materiality, and governance integration jointly shape financial outcomes across institutional settings.

The paper contributes a governance-centered framework that integrates empirical findings from meta-analyses, event studies, materiality research, and governance literature into a structured set of conditions for fiduciary evaluation. By reframing ESG as a conditional component of capital allocation rather than a source of systematic outperformance, it provides a practical lens for boards and investment committees to assess stakeholder exposure within existing risk and governance systems.

The analysis proceeds as follows. Section 2 reviews the empirical evidence on ESG and financial performance. Section 3 describes the methodological approach. Section 4 examines the three principal channels through which ESG may affect financial outcomes. Section 5 identifies the boundary conditions under which effects do not arise. Section 6 proposes a governance framework for fiduciary evaluation. Section 7 discusses implications for boards and investment committees. Section 8 outlines limitations. Section 9 concludes.

2. What the Evidence Actually Shows

Before turning to the mechanisms through which ESG may affect financial outcomes and governance implications, it is necessary to examine what the empirical literature actually shows. The research does not provide a single definitive answer. Instead, it reveals patterns, limitations, and conditional effects that frame the debate more precisely.

2.1 The overall direction of the evidence

Over several decades, researchers have examined the relationship between corporate social performance and financial outcomes. Large-scale meta-analyses synthesizing hundreds of studies report a modest positive association between corporate social performance and financial outcomes (Orlitzky et al., 2003; Margolis et al., 2009). The average effect size is small and highly heterogeneous.

This does not imply that ESG guarantees superior returns. It indicates that stakeholder governance correlates with financial performance under certain conditions. Industry structure, measurement choices, and time horizon materially influence results. The center of gravity of the literature is conditional: modest average association, substantial dispersion.

2.2 Measurement error and ratings disagreement

Measurement challenges contribute materially to heterogeneity. ESG ratings from different providers frequently diverge in their assessments of the same firm (Berg et al., 2022). Differences in methodology, weighting, and data construction produce substantial disagreement.

For fiduciaries, this has practical implications. Composite ESG scores may reflect reporting quality or disclosure breadth as much as operational discipline. Aggregating environmental, social, and governance factors further blurs the specific ways in which each may affect financial outcomes.

In institutional allocation settings, ESG ratings often appear prominently in marketing materials. High ratings do not necessarily indicate embedded risk control. Without examining operational integration, reliance on scores provides false precision. Measurement noise weakens observed statistical relationships and reinforces the need to examine how specific factors affect financial outcomes rather than relying on broad correlations.

2.3 Challenges in determining cause and effect

Financially stronger firms often have greater financial flexibility, enabling them to invest in stakeholder initiatives (Waddock & Graves, 1997). This complicates efforts to determine whether ESG improves performance, or whether strong performance enables ESG investment. Observed correlations alone cannot establish whether ESG causes stronger performance or merely accompanies it. Researchers have attempted to address this using time-lagged analyses and event studies, yet isolating direction of cause remains difficult.

This possibility does not eliminate the potential for ESG to have genuine financial impact. It underscores the need to examine how ESG might influence financial outcomes, rather than relying solely on correlation.

2.4 Time horizon and aggregation problems

Many ESG-related investments generate financial effects over extended horizons (Edmans, 2011). Environmental transition investments, workforce development, and supply chain redesign may influence performance over multi-year periods. Short-term evaluation windows can therefore understate long-duration effects. Firms operating under quarterly performance pressure may underinvest in economically material stakeholder initiatives.

Aggregation across industries introduces further distortion. Environmental exposure is structurally more material in capital-intensive sectors — such as infrastructure and energy — than in asset-light businesses. Pooling such firms can dilute sector-specific relationships. Measurement error, the possibility that strong performance enables ESG investment rather than the reverse, time horizon constraints, and aggregation effects explain much of the literature's apparent inconsistency. The evidence is mixed not because it is incoherent, but because mechanisms operate conditionally — these effects depend on industry exposure, governance quality, and time horizon.

Table 1. Summary of empirical evidence on CSR/ESG and financial performance

Evidence Category	Typical Finding	Strength of Evidence	Key Limitation	Fiduciary Interpretation
Meta-Analyses (CSR/CSP & Financial Performance)	Modest average positive association	Moderate (large sample synthesis)	Heterogeneity; correlation \neq causation	ESG not universally value-enhancing; effects are conditional
ESG Ratings Disagreement Studies	Significant variation across providers	Strong (methodological clarity)	Measurement noise; aggregation issues	Ratings are screening tools, not decisive indicators
Event / Crisis Studies (“Reputation Insurance”)	Firms with stronger prior CSR suffer smaller negative reactions during adverse events	Strong (event-based methodology)	Contingent; effect visible mainly in downside states	ESG most defensible as downside risk mitigation
Materiality-Based Studies	Financial benefits concentrate in economically material ESG issues	Moderate to Strong	Industry-specific; dependent on classification	Capital discipline requires identifying economically material risks
Governance Integration Research	Operational embedding and governance oversight drives ESG outcomes	Moderate (governance-performance linkage)	Hard to isolate mechanism	Governance quality determines realization
Short-Termism / Horizon Literature	Long-duration investments may be undervalued under short-term pressure	Moderate	Measurement over extended horizons	Capital duration determines ESG payoff

Sources: Orlitzky et al. (2003); Margolis et al. (2009); Berg et al. (2022); Minor & Morgan (2011); Khan et al. (2016); Edmans (2011).

3. Methodology

This paper adopts a conceptual synthesis approach, drawing on multiple strands of peer-reviewed empirical research and practitioner evidence. The source base includes large-sample meta-analyses of corporate social performance and financial outcomes, studies of ESG ratings disagreement and measurement methodology, event-based analyses of firm performance during adverse conditions, and research on economic materiality and governance integration.

Rather than conducting original empirical testing, the paper evaluates patterns and boundary conditions across these bodies of evidence to identify consistent economic channels and the conditions under which they operate. This approach is appropriate for research questions that seek to integrate heterogeneous empirical findings into a unified analytical framework, particularly where the primary contribution is integrating existing research into a structured framework rather than generating new data (Torraco, 2005; Tranfield et al., 2003).

The analysis is organized around three analytical constructs — economic materiality, governance integration, and institutional time horizon — that function as the primary conditioning variables for evaluating when and how ESG-related factors influence financial outcomes. The resulting framework is designed to bridge empirical research and institutional practice by translating heterogeneous academic evidence into structured guidance for fiduciary decision-making.

4. Economic Channels: How CSR/ESG Can Affect Financial Outcomes

If the aggregate evidence shows a modest and heterogeneous relationship between CSR/ESG and financial performance, the relevant question is: through what specific channels do such effects arise?

Rather than treating CSR/ESG as a single undifferentiated factor, analysis should distinguish among distinct pathways of financial influence. The literature supports three principal channels: downside risk mitigation, financially material competitive positioning, and governance integration and operational discipline. The strength of each mechanism depends on industry exposure, execution quality, and institutional time horizon.

4.1 Downside risk mitigation ("reputation insurance")

The most consistently supported mechanism is downside risk mitigation. Event-based studies examining corporate crises suggest that firms with stronger prior CSR performance experience less severe negative stock reactions following adverse events (Minor & Morgan, 2011).

This has been described as a form of reputation insurance. Stakeholder goodwill accumulated through credible practice may buffer financial damage during crises. This effect is contingent — it becomes visible primarily in adverse states.

The protection that CSR provides comes from operational discipline — not from visible charitable giving or public commitments. Firms that publicly promote ESG commitments while

tolerating operational weaknesses may not receive protection — and may face amplified penalties. For institutional allocators, this distinction is critical. ESG positioned as branding without operational embedding provides no insurance. Risk mitigation arises from governance discipline, not narrative alignment. This dynamic aligns with fiduciary priorities: reducing tail risk affects long-term value even when average returns are unchanged.

4.2 Strategic materiality and competitive positioning

Financial impact concentrates where ESG initiatives target economically material exposures (Khan et al., 2016). Material issues are those directly linked to regulatory exposure, cost structure, capital intensity, or competitive positioning.

Boards often discuss ESG categories broadly rather than mapping them to asset-level economics. Climate risk may be addressed in portfolio commentary without evaluating specific asset transition exposure, regulatory jurisdiction, or capital structure sensitivity.

In capital-intensive sectors such as infrastructure and energy, stakeholder risk is inseparable from regulatory and transition exposure. In these contexts, ESG integration is less about signaling and more about underwriting discipline. Conversely, generic sustainability initiatives with weak linkage to economic drivers do not produce durable financial effects. Strategic materiality aligns stakeholder spending with capital allocation discipline.

4.3 Governance integration and operational discipline

Governance integration determines whether financial effects are realized. Stakeholder risks must be incorporated into enterprise risk management systems, capital budgeting decisions, incentive structures, and board oversight processes (Eccles et al., 2014).

In institutional settings, ESG frequently appears in standalone reports or marketing materials, but less frequently in underwriting models or compensation structures. Where integration is absent, financial effects are limited. This reinforces the central theme: ESG's financial relevance depends not on public commitments but on institutional execution.

5. Boundary Conditions: When CSR/ESG Does Not Pay

If CSR/ESG's financial impact is conditional, then underperformance is not an exception — it is a predictable outcome when economic linkage and governance discipline are absent. Clarifying these boundary conditions is essential for fiduciaries. Without them, stakeholder initiatives become branding exercises rather than genuine components of risk management.

5.1 Immaterial issue spending

CSR/ESG initiatives that are economically immaterial to a firm's industry exposure do not generate durable financial return. In institutional allocation contexts, it is common to see ESG commitments framed broadly — covering environmental stewardship, diversity goals, or

community engagement — without explicit articulation of how those initiatives connect to revenue drivers, regulatory risk, or cost structure. Without that linkage, stakeholder initiatives do not affect financial performance.

Research distinguishing material from immaterial sustainability issues finds that performance effects concentrate in economically material issues (Khan et al., 2016). When firms invest in immaterial domains while underinvesting in economically relevant exposures, expected financial benefit is limited. This is not a critique of social value. It is a capital allocation discipline. Fiduciaries must distinguish between socially desirable initiatives and economically material risk controls.

5.2 Disclosure without operational integration

A second failure mode arises when ESG efforts remain primarily at the level of disclosure. ESG is frequently prominent in marketing materials, sustainability reports, and investor communications, yet operational integration — embedding stakeholder risk into underwriting models, capital budgeting decisions, and executive incentives — is frequently absent.

Measurement disagreement across ESG ratings providers reinforces this concern (Berg et al., 2022). Improvements in reported scores may reflect enhanced disclosure or reporting sophistication rather than meaningful operational change. Disclosure enhances transparency; operational discipline alters risk. Without integration into governance systems, financial impact is minimal.

5.3 Horizon mismatch

Even economically material ESG investments fail to generate observable financial benefits when capital duration is misaligned. Environmental transition investments, workforce development, and supply chain redesign frequently produce effects over multi-year horizons (Edmans, 2011). Firms operating under short-term market pressure may underinvest in such initiatives or be unable to capture their compounding benefits.

Investment strategies evaluated primarily on short-term relative performance may discount long-duration risk mitigation, treating ESG as a discretionary add-on rather than structural exposure management. Horizon alignment is therefore a necessary condition. Without duration of capital and governance patience, even well-targeted stakeholder investments may not translate into observable financial improvement.

5.4 Inconsistent signaling and credibility gaps

A final boundary condition concerns credibility. Firms that promote stakeholder commitments while tolerating operational weaknesses risk amplified penalties during adverse events. Evidence suggests that reputation functions as protection only when practices are perceived as credible and consistent (Minor & Morgan, 2011).

Inconsistent signaling — public commitments unsupported by governance integration — erodes trust more quickly than silence. In institutional allocation settings, such inconsistencies are often revealed only during stress events. Narrative alignment without operational alignment does not provide economic protection.

6. A Governance Framework for Fiduciaries

If CSR/ESG's financial relevance is conditional, fiduciaries require structured evaluation. Without such structure, stakeholder initiatives are treated either as guaranteed value drivers or as ideological expenditures. The framework below synthesizes the preceding analysis into three governance tests: materiality, credibility, and horizon alignment. These are lenses for disciplined oversight — not scoring models and not moral judgments.

6.1 The materiality test

The first question is economic: Is the ESG issue structurally linked to the firm's industry exposure and business model? Materiality requires a clear explanation of how the issue affects financial outcomes. Stakeholder risks must connect to regulatory exposure, capital intensity, cost structure, supply chain dependence, or revenue sensitivity.

A disciplined materiality test requires identification of economically significant exposures; explicit articulation of how those exposures affect revenue, cost, risk, or capital; and prioritization based on exposure magnitude. Without this mapping, ESG initiatives scatter resources across immaterial domains. Boards that review ESG categories at a high level — without mapping them to asset-level economics — apply the label without applying the discipline.

6.2 The credibility test

The second question is institutional: Are stakeholder risks embedded within governance systems? Credibility requires integration into enterprise risk management, board oversight of economically material exposures, alignment with executive incentives, measurable operational metrics, and clear accountability structures.

In institutional allocation settings, ESG is frequently positioned as a commitment or value statement rather than embedded in underwriting assumptions, compensation design, or capital allocation models. Where governance systems incorporate stakeholder exposure into decision-making, financial effects — particularly in downside states — materialize. Where they do not, the result is branding without discipline: public commitment without operational substance.

6.3 The horizon alignment test

The third question concerns duration: Does the institutional structure allow stakeholder investments to compound? Even when ESG initiatives are material and governance-integrated,

realization depends on time horizon. Capital-intensive sectors such as infrastructure and energy often operate on long-duration cash-flow models, where environmental and regulatory exposures are inseparable from underwriting discipline.

Conversely, strategies operating under shorter capital cycles may incorporate ESG selectively, emphasizing exposures with near-term financial impact. Horizon alignment determines whether ESG functions as structural risk management or a non-core add-on. Fiduciaries must evaluate whether incentive systems, stability of investor base, and performance measurement horizons are consistent with the time horizon of stakeholder investments.

The materiality, credibility, and horizon alignment tests convert a polarized debate into structured governance analysis. They neither assume ESG superiority nor stakeholder irrelevance. Instead, they treat stakeholder exposure as a conditional component of capital discipline.

7. Implications for Boards and Investment Committees

If CSR/ESG's financial relevance is conditional and pathway-dependent, fiduciary oversight must be equally disciplined. Treating stakeholder initiatives as automatic value enhancers or symbolic expenditures reflects insufficient analytical structure. For boards and investment committees, the operative question is not whether to endorse ESG, but how to evaluate economically material stakeholder exposure within the broader framework of risk oversight and capital allocation.

7.1 Questions boards should ask

Boards should begin with exposure clarity rather than generalized commitment. A disciplined discussion starts by asking which stakeholder risks are most economically material given the institution's industry structure, regulatory environment, and operating footprint. It then identifies where asymmetric downside events — regulatory penalties, operational failures, litigation, or license-to-operate risks — are most concentrated. It assesses whether those exposures are explicitly incorporated into enterprise risk management systems and how ESG-related metrics are linked, if at all, to executive incentives and capital allocation decisions. It also asks where resources may be allocated to immaterial initiatives while economically significant risks are underweighted, and how stakeholder exposures would behave under credible stress scenarios. These questions shift ESG from value signaling to risk architecture and reinforce fiduciary responsibility: stakeholder governance is relevant when it is economically consequential.

7.2 Interpreting ESG ratings

Investment committees frequently encounter ESG scores in manager presentations, portfolio screens, and benchmarking exercises. These inputs are informative but require disciplined interpretation.

Given documented disagreement across ratings providers and limited methodological transparency (Berg et al., 2022), ESG scores should be treated as screening inputs rather than conclusive assessments of risk quality. Committees should distinguish between relative positioning within a ratings framework, the underlying operational practices that framework is designed to measure, and industry-specific economic exposure that may not be reflected in any composite score at all. High scores may reflect disclosure sophistication. Low scores may reflect methodology differences rather than unmanaged risk. Ratings provide signals; they do not substitute for governance analysis.

7.3 When to discount ESG claims

Boards and investment committees should discount stakeholder claims where execution is unclear. Indicators of superficiality include extensive sustainability disclosures without measurable operational KPIs; public commitments not reflected in capital budgeting decisions; material regulatory or environmental exposure lacking dedicated oversight structures; and ESG positioning disconnected from asset-level underwriting. In institutional settings, ESG often appears prominently in marketing materials, particularly within private market strategies. Fiduciaries must distinguish between signaling alignment and demonstrable risk control. This is not skepticism toward ESG as a concept. It is skepticism toward unverified integration.

7.4 When to underwrite ESG as structural risk control

Conversely, there are contexts in which stakeholder governance requires formal underwriting as part of structural risk management. These include capital-intensive industries with regulatory or environmental exposure, infrastructure and energy assets subject to transition risk, businesses dependent on long-duration licenses or public trust, and supply chains exposed to geopolitical or labor instability. In these settings, stakeholder exposure is inseparable from economic durability. ESG integration functions less as a discretionary add-on and more as core underwriting discipline. The objective is not to elevate ESG above financial analysis. It is to incorporate economically material stakeholder risks into the same structured evaluation applied to leverage, liquidity, and competitive positioning.

Additionally, the framework is designed primarily for institutional capital contexts and may be less directly applicable to smaller firms or markets with different governance structures.

8. Conclusion — A Governance-Centered Position

The debate over CSR and ESG has too often been framed as a question of belief rather than governance discipline. The empirical literature does not support universal claims of systematic outperformance. Nor does it support dismissal of stakeholder exposure as financially irrelevant.

The evidence instead indicates that stakeholder governance affects the distribution of financial outcomes under identifiable conditions. The most defensible mechanism is downside risk mitigation. Material exposure determines where that mitigation is economically relevant.

Governance integration determines whether it is realized. Horizon alignment determines whether it compounds.

For fiduciaries, the implication is structural rather than ideological. Economically material stakeholder risks belong within formal risk oversight. Where exposure is significant, treating ESG considerations as peripheral reflects incomplete governance, not prudent restraint.

CSR/ESG is neither a guaranteed source of excess returns nor a marketing category. It is a conditional component of capital discipline. Institutions that approach it with structured analysis — mapping materiality, embedding governance, and aligning duration — are better positioned to preserve durability in uncertain environments.

A governance-centered interpretation moves the discussion beyond advocacy and skepticism. It restores the debate to fiduciary clarity.

9. Limitations

This paper is conceptual in nature and does not conduct original empirical testing. Its conclusions are based on synthesis and interpretation of existing literature, which itself reflects measurement challenges, methodological variation, and differences in industry context.

While the framework identifies conditions under which ESG may influence financial outcomes, it does not quantify effect sizes or establish causal relationships in specific settings. Future research may extend this analysis through empirical testing across asset classes, industries, and time horizons.

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