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DOES GREATER ENGAGEMENT IN ESG BY LISTED FIRMS RESULT IN ENHANCED FINANCIAL PERFORMANCE? A COMPARATIVE STUDY BETWEEN FINLAND AND EUROPEAN COUNTRIES.

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ACKNOWLEDGMENT

"Avoid at all costs, whether out of fear or lack of courage, the mistake of not trying. It will only bear the bitter fruits of regret. Always move towards action and progress. Pursue what you truly desire, not what others expect of you."– Thomas Benvissuto

Today marks the end of a significant chapter in my life. First and foremost, I would like to express my deepest gratitude to my parents, who have supported me from the very beginning of this journey at HEC Liège and throughout my adventure in Finland. Without their unwavering encouragement, I would not be here today, writing these lines.

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If I can leave you with one piece of advice: always believe in yourself.

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ABSTRACT OF THE MASTER'S THESIS

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Abstract

Using a sample of European countries (specifically, France, Germany and Finland), this thesis aims to explore the relation between Environmental Social and Governance (ESG) performance and financial performance. While ESG factors increasingly feed into corporate strategies and stakeholder interactions, the material impact of these factors on financial performance is still disputed. The analyses are based on two key performance measures, both for the same set of firms: Return on Assets (an accounting-based firm performance measure), and Tobin's Q (a market-based valuation measure). This study contributes to the existing literature by analyzing how both overall ESG performance, and its three individual components, are related to the profitability and market valuation of a firm.

A panel data of 136 companies from 2014 to 2019 is used in this study to examine the relationship of ESG metrics and indicators of financial performance. Preliminary results indicate the high-level ESG score has little immediate effect. But the social and governance dimensions show stronger effects, although not entirely encouraging across the board. This nuanced relationship suggests that while ESG strategies are unlikely to yield guaranteed short-term financial performance, they may indeed provide long-term value drivers where regulations and expectations from the bodies of interest are strong.

These results are helpful to the ongoing conversation in ESG finance because they argue that ESG should not be viewed as just a compliance requirement, but rather a strategic imperative that can help organizations create sustainable value over the long term. The study concludes with managerial implications for corporate leaders, as well as recommendations for future research considering the industry specificities in the practices of ESG.

Keywords

Sustainability, CSR, ESG, Financial Performance

CONTENTS

FIGURES

TABLES

1 INTRODUCTION

The concept of green business practices really began in the early 1960s, says Trompeter, though it has become more popular over the past few years. Companies noticed the increasing level of environmental awareness and concern by consumers. At present, our annual total consumption of resources exceeds our planet's annual output, according to the Global Footprint Network, an international think tank, which develops and promotes tools for sustainability (Viswanathan & Varghese, 2018).

Corporate social responsibility (CSR) has emerged not just due to current challenges such as environmental damage or social instability, but because of more profound and lasting changes in society. As suggests, CSR represents more than just a passing trend or a tactical reaction to external demands. It implies a fundamental evolution in how society views the responsibilities of businesses. Firms nowadays need to provide not only economic value, but also adhere to changing demands for accountability, fairness and social legitimacy. Some companies are pursuing ESG from a sincere belief in societal welfare, whereas for others it is about to gain the benefits of a good reputation and avoid more rigorous regulation of what they do.

Corporate social responsibility did not appear in response to environmental degradation, social turbulence and the like, but is indicative of a wholesale deep social change. CSR according to (Votaw, 1972) should not be looked at as a passing fad or as a strategic effort in responding to the society but as part of the deep change that the society is undergoing in terms of its expectations of businesses. By now, companies are required not just to create value but also to conform to new expectations of accountability, fairness and social rightness. On one hand, some companies implement ESG because of a sincere desire to benefit society, while other companies may adopt ESG standards for the sake of gaining a competitive edge or from a desire to avoid and preempt more rigorous regulation (Sprinkle & Maines, 2010).

Over the past few years, environmental, social, and governance factors have evolved from outliers into mainstream corporate and investor concerns. What was once considered a trend or one of PR's fancy feminine cousins has pushed its way into an essential, strategic position that mirrors systemic changes to the company's business model. The voluntary non-financial reporting, especially ESG information, has become more and more relevant. Consequently,

corporate documents such as integrated reports, sustainability reports, and social impact disclosures are becoming strategic tools for corporate communication and stakeholder engagement (Vitolla et al., 2020). Today, more than 90% of S&P 500 companies release ESG reports and ESG-oriented investments have increased dramatically, which is a testimony of the increasing focus on sustainable business models. Companies are increasingly under pressure to control their externalities, and defend their "social license to operate," not only to avoid regulation, but ultimately to compete and enjoy trust over the long term. But the connection between engaging on ESG (environmental, social, and governance) and financial value has been heavily debated. For some, ESG is a driver of value, for others it's not clear there's a return or they dismiss it as greenwashing (McKinsey, 2022)

Beyond the practical considerations, ESG is also being driven increasingly by normative stakeholder theory, which holds that companies owe moral duties to all of their stakeholders, not just shareholders (Garriga & Mele). But these changes don't come free, and so that leads us to one crucial question that is being asked again : Does more ESG engagement actually translate into better financial performance? For example, organizations may achieve long-term success if they consider all vested interest in a business strategy, not just shareholder interest, according to stakeholder theory in general. Recent empirical evidence corroborates this framework. A recent literature review by Aydoğmuş et al. (2022) finds that ESG performance is positively and significantly related to both with firm value and profitability, especially on the social and governance side. Environmental activities are a long-term concern for their financial effect, even though firms have a specific strong association between environmental and financial performance.

Several studies have examined the association between ESG and financial performance. Scholars such as Shakil (2019), Velte (2017) and Saeidi et al. (2015) found a direct relationship between them. However, the work of Chouai et al. (2021) and Lu et al. (2018) showed a negative correlation. Recent works including Hansen and Xie (2025) and Lodha (2024) also failed to report any statistically strong relationship. Yet, while there is a considerable amount of literature on sectoral and country differences there is the lack of them at least for high ESG-performing countries such as Finland, Germany, and France. That gap will be filled by this thesis, which will compare the ESG performance specifically in the European context. In Statista's 2024 report, Finland scored a stellar 97, the second best after Denmark (Statista, 2024). Moreover, the 2024 Sustainable Development Report rated Finland

number one among the 193 UN member nations, in terms of its progress on the UN's Sustainable Development Goals. Those accolades underpin the fact that Finland takes sustainability very seriously, and for that reason, should be treated as a prime example of the results that can be achieved when focusing on ESG initiatives and their implications on financial performance (SDG, 2024). In contrast, Robeco's much-cited ESG report, which rates 150 countries on a variety of ESG criteria attractive to investors and policymakers, ranks Germany 8th and France 15th (Robeco, 2024).

After this introductory chapter, the thesis will include a review of literature to overview the foremost theoretical perspectives and an overview of the literature in the field of topic. Then, the research will concentrate in the empirical analysis and analysis of data which will be analyzed by statistical tools to see whether there is any association between certain ESG performance and financial performance, i.e. profitability and/or market value. The research sample of 136 organizations during the years 2014–2019 is derived from LSEG and it aims at contributing variety to the ESG–financial performance debate. The methods section will describe the data sources, the variables examined, and the statistical methods used. Results will then be interpreted and discussed in relation to existing literature in on the practical implications. The article ends by proposing future research directions and predictions concerning the future of ESG.

In the course of this study, two questions will be tackled: The first one is to know whether the general ESG affects the financial performance of the companies. The second decomposed each ESG pillar to test whether or not some of the pillars have significant effects on the financial performance of the firms. The results indicate that, although the level of the overall ESG score has a marginal direct impact on the financial performance, the social and governance dimensions influence the financial performance more, even with negative impacts in some cases. These findings are consistent with the hypothesis that ESG investments could lead to initially higher costs of operations, and may need more time to see benefits.

In conclusion to this thesis, it can be inferred that ESG is not always positively related to financial performance. The effects of ESG can be slow to emerge. That's evidence that while ESG strategies may not produce immediate financial returns, they remain a key player in improving long-term resiliency, reputation and trust among stakeholders. As such, companies should not be looking at ESG purely as dollar signs only focused in the short term, but an area

of investment that is made toward a strategic effort of sustainable value creation. Future studies may investigate other industries, regulations and stakeholder pressures, and how they influence the financial effects of ESG initiatives.

2 CORPORATE SOCIAL RESPONSIBILITY AND ESG

2.1 Sustainability in Finance

The world economy expanded in an era when abundant natural resources were the norm. With forests used up, societies increasingly relied on fossil fuels and other non-renewable energy sources. The greater energy use also facilitated access to other raw materials. The first to sound the alarm that Earth would not be able to support rapid economic and population growth past the year 2100 was the early 1970s 'Club of Rome.' (Schoenmaker & Schramade, pp. 5–6).

Sustainability concerns the impact of our actions today for the future of ecosystems, societies and the environment. In order to birth this idea, it has to be perceived by businesses and organizations as a long-term approach which broadens their responsibilities to be more ethical, sustainable and human businesses that take into account employee well-being, environmental impact and customer needs. (Ameer & Othman, 2012, p. 61)

In a recent paper they've written about sustainable finance, (Edmans & Kacperczyk, 2022, p. 1309) defined the expression as "the integration of environmental, social, and governance issues into financial decisions." Today, business sustainability is a huge part in how companies are viewed in the world. All these business trends can be linked back to society, as companies that positively impact society are increasingly rewarded by customers and talent who care about issues like climate change and financial inclusion.

Foundational to sustainable financial practices is the concept of the Triple Bottom Line. This idea was first coining by Elkington (1997) and is centered around sustainability using a framework to measure a company's success through economic, social and environmental lenses. Its economic dimension considers how a company's practices support economic growth in a manner that can be sustained for future generations. The social aspects when it comes to Fair and Ethical business practices that contributes to employees, human capital, community, and the way business contributes back to society. Finally, the environmental dimension advocates for responsible use of resources, reduction of greenhouse gas emissions, and minimizing the environmental impact of an organization in order to preserve the environment for future generations (Lee & Mao, 2015, pp. 6–8)

(Arowoshegbe & Emmanuel, pp. 88–93)., on the other hand, discusses sustainability, the Triple Bottom Line, and how business activities are events that have economic, social, and environmental value. The new concept focuses on maximizing economic and social well-being while staying within nature's limits. It inspires businesses to look beyond short-term financial targets and instead act towards long-term social, environmental and economic sustainability.

2.2 Green Finance

Green finance is increasingly important and is an essential part of sustainable finance. It means allocating financial resources to initiatives that foster ecological sustainability, a prime example being renewable energy sources and energy efficiency. Green finance is crucial for the sustainability of the financial sector itself, being a key driver of large transformation. It prioritizes financing for environmentally sound and socially responsible projects in support of sustainable development. This mechanism encompasses all financial tools, such as green bonds, green banks, instruments of the carbon market… These are aimed at supporting the green business. Green finance specifically attracts socially aware investors, as it lowers the monetary obstacles for eco-friendly corporations.

Green finance is now a critical driver in facilitating sustainable development and aligning with sustainable development goals. It is crucial addressing global environmental issues including climate change, biodiversity loss, and resource consumption. It is inextricably tied to ESG factors and corporate performance. (Chandran & Chandran Mc, 2024, p. 2).

2.3 CSR

CSR was created as a response to unethical corporate actions surrounding social issues, that do not directly touch a company’s bottom line. Among these issues are environmental concerns, labour rights, human rights violations (especially in developing countries). CSR was initially viewed as voluntary actions taken by businesses to address these challenges. Additionally, it has also been associated with both corporate philanthropy and charitable actions, which are commonly used to enhance public image and to demonstrate that organisations are responsible. It has been interpreted as a means of self-policing among businesses, motivated

by virtue and the notion that ethical conduct improves public opinion, and therefore profits (Adeyeye, 2012, p. 7).

Businesses were introducing their own CSR programs from the earliest point in the formation of the adoption of corporate responsibility to try and gain a competitive advantage in the market (Lew et al., 2024, p. 311). CSR trends and practices in the last two decades have shown that social responsibility has an ethical and business dimension. At present time of high global competition, CSR only makes sense when its realization leads to corporate prosperity (Šefránek & Mikle, 2022, p. 21).

Controversy has ensued, with two predominant viewpoints emerging. On one side, there are those who claim that a business's only social responsibility is to increase profits as long as it does so within the legal and ethical framework of society (Friedman, 1970; Levitt 1958). Conversely, some argue for a wider set of business obligations to society (Andrews 1973; Carroll 1979; Davis and Blomstrom 1975; Epstein 1987; McGuire 1963) (Schwartz & Carroll, 2003, p. 503).

As CSR becomes more and more discussed, businesses should consider the needs of several recipients, alongside the social, political, economic, environmental as well as developmental consequences of their actions. The pursuit of profits by multinational corporations has driven them to engage in several activities of questionable ethicality, often with grave consequences in developing countries (Adeyeye, 2012, p. 1).

In the early 21st century, a range of authors sought to define the CSR. One of the well-recognized authors Carroll, who divided CSR into ethical, moral and economic phases, announced the CSR potential requires prosperity of companies to grow. As noted by Visser in 2008, social responsibility does exist but not up to be implemented as should be. Philanthropic responsibility[1]is one of its aspects most commonly discussed since it makes a positive impact on a company's image and was increasing CSR uptake internationally. But while there are many authors who say businesses that pursue social responsibility simply as a means to fame often fail. They argue that CSR cannot be implemented in a piecemeal fashion, and therefore cannot be limited to selective inclusion. Following these discussions, CSR gained increasing popularity, leading to widespread adoption among companies. Researchers concluded that CSR

not only enhances corporate reputation but also fosters stronger relationships with stakeholders (Šefránek & Mikle, 2022, p. 25).

Both sustainable development and CSR have become very important as management concepts and indicators of business performance The theory of CSR is brief and is oriented towards the organization and is an answer to the necessity of sustainable development (Poznań University of Economics and Business & Kaźmierczak, 2022, p. 277).

CSR primarily refers to the activities undertaken by the enterprises to shape qualitative processes related to their social obligations, particularly in connection with the use of nature resources and their impact on both internal and external environments. ESG Environmental, Social Governance factors are measurement tools that quantify and evaluate a company's CSR initiatives (Lew et al., 2024, p. 311).

The primary goal of enterprises that are considering or have already implemented CSR principles, either partially or fully, is to enhance their positive perception among the public, particularly among current and potential customers. To this end, companies issue reports demonstrating their impact on the environment and society. The main purpose of CSR initiatives is to reduce or mitigate the negative impacts business activities may have on the environment and the society, whether they are real or potential (Lew et al., 2024, p.311). CSR is defined as responsibility of companies towards the society whenever they start impacting community more than their own business interests, particularly stakeholder affected directly from their activates. As per CSR, it is not the responsibility of only big multinational organizations. Smaller firms should also integrate responsible practices into their operations. It is to make business activities compatible with social expectations by bridging the gap between the corporate world and society. Focusing solely on financial profits caused damage to the environment and harm to social welfare (Kuisma, 2024).

Until today, in some countries CSR is not a statutory requirement and whatever assistance enterprises provide to the social issues is a voluntary one. Since 2018 the new rules for non-financial reporting, consistent with the Directive 2014/95/EU, has been introduced and since the last years regulations regarding CSR is being tighten. As per it, data including to CSR should be present as non-financial statement in company financial reports. More specifically,

such reporting is mandatory for those companies employing over 500 employees, which constitutes about 6000 entities in the EU, in particular listed companies, banks, insurance companies and other entities assigned by national authorities as public-interest entities (Księżak & Fischbach, 2018, p. 98).

The advancement of CSR leads to the evolution of related concepts. New instruments and initiatives are emerging to support the green economy and to promote the transition to fully sustainable economic growth in many developed economies. As for the specific regions like EU, US and China, the green economic actions are slowly developing into a overall potential goal for the society (Lew et al., 2024, p.312).

CSR has come a long way and has a bright future ahead. It is increasingly essential and widespread, garnering support, adaptation and application by businesses. The embrace of CSR (now commonly known as purpose or sustainability) by corporations has been an important driver in the ongoing growth of CSR (Šefránek & Mikle, 2022, p. 21).

2.3.1 Carroll's Pyramid of CSR (1991)

The establishment of Corporate Social Responsibility in 1979 is basically defined in four parts which can be summarized into four groups of stakeholders: employees, consumers, shareholders and community. In 1991, Carroll proceeded to develop this approach in his CSR Pyramid, which is the visual representing the four forms of responsibility businesses have over (Carroll, 2016, p. 4). Carroll attempted to reconcile economic goals with social responsibilities, evidenced through a more defined description of CSR: "The social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time." (Schwartz & Carroll, 2003)

One of the most acknowledged versions of Carroll's Pyramid is a four-part model that characterizes corporate responsibilities by economic, legal, ethical and philanthropic duties (Schwartz & Carroll, 2003, p. 504). These four responsibilities structure the foundation upon which businesses are expected to be and perform in society (Carroll, 2016, p. 2).

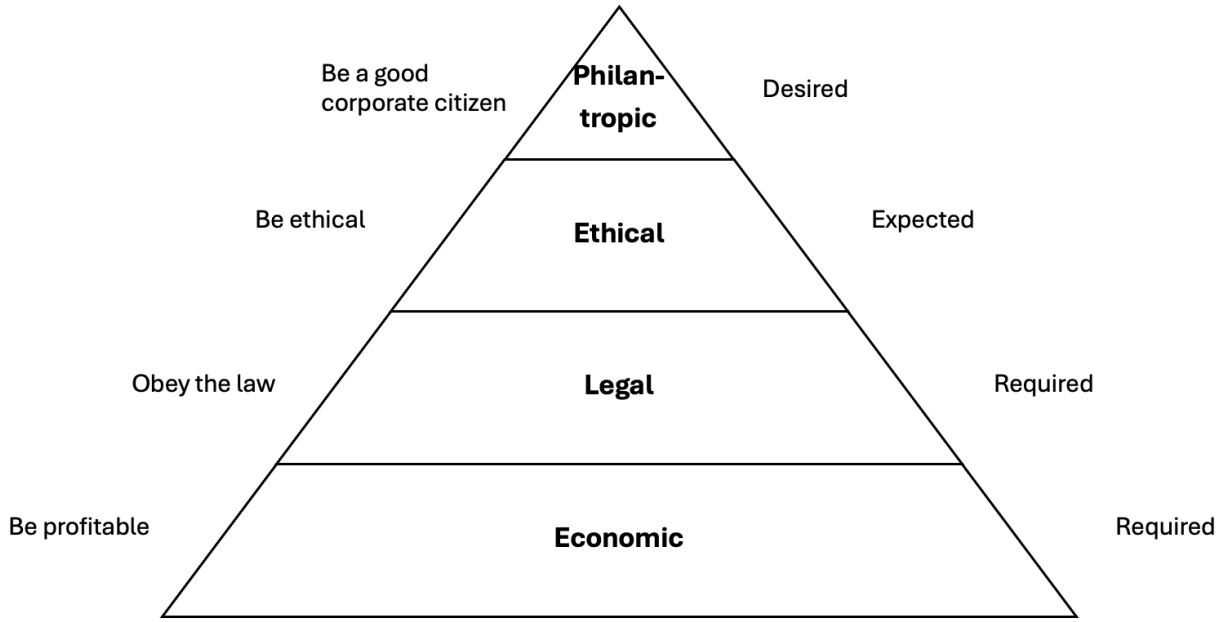

Figure 1. The pyramid of CSR (adapted from Schwartz & Carroll, 2003, p.504)

In Carroll's Pyramid, economic responsibility is the base of the pyramid because it is an essential building block for any business to exist. Sustained profitability is key to delivering against society's wider expectations of business. If companies don't make a profit, they can't go on producing and selling the goods and services that people want. In return, they are given the chance to make profits, so owners and shareholders will invest. Profits lead to the ability to reward investors, and they're critical for growth. Reinvested profits mean more goods at lower costs, ultimately improving the economy. CEOs and entrepreneurs must acknowledge that, at this scale, whether for profit or not, is the difference between success and matchmaking for businesses whereas, actually, almost all economic systems put forward that businesses need to be profiting. From managing revenue to minimizing costs, making investments, and even selling, businesses are holding up their end of the economic bargain with a variety of financial strategies. In the current global economic landscape, financial sustainability has never been more important. If a company cannot sustain itself, it inherently cannot meet other obligations like legal, ethical, charitable. Hence, economic responsibility acts as the ground on which all other corporate responsibilities are built (Carroll, 2016, p. 3).

The second level of Carroll's Pyramid is legal responsibility. Society likes companies better to abide by laws and rules, as they construct the primary framework on which companies function in a structured society. Laws act as a sort of "codified ethics" which outlines fair

business practices as determined by our federal, state and local governments. Businesses have a legal responsibility to act per government and legal expectations, adhere to federal, state, and local guidelines, and be law-abiding corporate entities. Furthermore, they are expected to fulfill all legal obligations owed to stakeholders, and that the products and services they provide meet at least minimum legal requirements. Ethical principles are closely connected with legal compliance, highlight the significance of integrity in corporate activities (Carroll, 2016, p. 3).

The third tier of Carroll's Pyramid is ethical responsibilities. While in the past they might have focused more on short-term profit maximization, businessmen are now expected to behave in a morally right, fair and just way so as to do no harm to the various stakeholders that support the company. These span beyond their legal obligations and can be activities, standards, policies and practices that are expected in society but not directly written into legislation. Following ethical duties means that businesses operate in accord with social values and moral principles, acknowledging and adhering to new or changing ethical expectations. Their primary objective should be to fulfill moral and ethical obligations as responsible corporate citizens, to ensure that ethical principles are not sacrificed for the sake of achieving business objectives. Moreover, businesses must realize that integrity and ethical behavior can be seen as a style of central to their operations, prioritizing the well-being of customers and society as a whole over profitability. In addition to these expectations, ethical responsibilities are informed by underlying moral philosophies such as rights, justice, and utilitarianism that should guide corporate actions and practices (Carroll, 2016, pp. 3–4).

Philanthropic responsibilities are at the top of Carroll's Pyramid, highlighting a business's role as a good corporate citizen. Social expectations assume corporations will reinvest in society through the sharing of financial, material, and human capital within their local communities. This element covers all types of corporate philanthropy and includes voluntary or discretionary activities that go beyond the minimum requirements of law or ethics. Philanthropy, though not a requirement, has become an assumed component of corporate behavior. In turn, businesses contribute to society by making monetary, product, and service donations, promoting employee volunteerism, and funding community development projects. While some corporations actually do have good intentions toward bettering society, others use philanthropy as public relations to strengthen their brand and show that they are engaging in CSR. Moreover, organizations are not seen as unethical if they do not engage with philanthropy,

unlike ethical responsibilities arising from moral duties, and society appreciates and promotes those in that respect (Carroll, 2016, p. 4).

CSR is still relevant in Europe, where its parts are more integrated than in America. In the case of developing countries, it also prioritizes economic responsibility first, but philanthropy is a secondary priority, followed by legal and ethical (Harrison, 2020). Visser also takes issue with the notion of CSR as being universal by pointing out that CSR domains vary due to regions having different cultural traditions, political systems, socio-economic priorities, governance structures, and crisis response differentials. Researchers have explored CSR's applicability to different organizational contexts, beyond geography. As the theory of CSR continues to develop, academics are in the process of rethinking and adjusting Carroll's Pyramid to meet the demands of various global, situational, and organizational environments. (Carroll, 2016, p. 7)

2.3.2 The New Pyramid of CSR

Carroll's model has been heavily criticized for as it erodes the moral base of CSR. The original model, with economic responsibilities and an overarching duty to the owners at the base of the pyramid, has shaped both business education and corporate decision-making, generally downgrading ethical and legal obligations in determining the responsibilities of corporations. With businesses increasingly influencing societal issues, scholars contend that the priorities of CSR should be reordered to be more ethical and less profit-driven to ensure companies act responsibly. Models like Carroll's pyramid shape not only our understanding of CSR as we come to it as outsiders, they shape how we apply this to businesses, and thus contribute to a double hermeneutic effect. When businesses are perceived to prioritize ethics and law over profit, it can shape their conduct in ways that encourage a greater commitment to acting responsibly. Similarly, it is argued, among other things, that outlining profitability and creating a relationship between CSR and profitability would ensure that CSR would be more attractive to companies. However, this approach risks diluting CSR's moral power, reducing it to a tool for business interests rather than a genuine commitment to social responsibility (Baden, 2016, pp. 10–11).

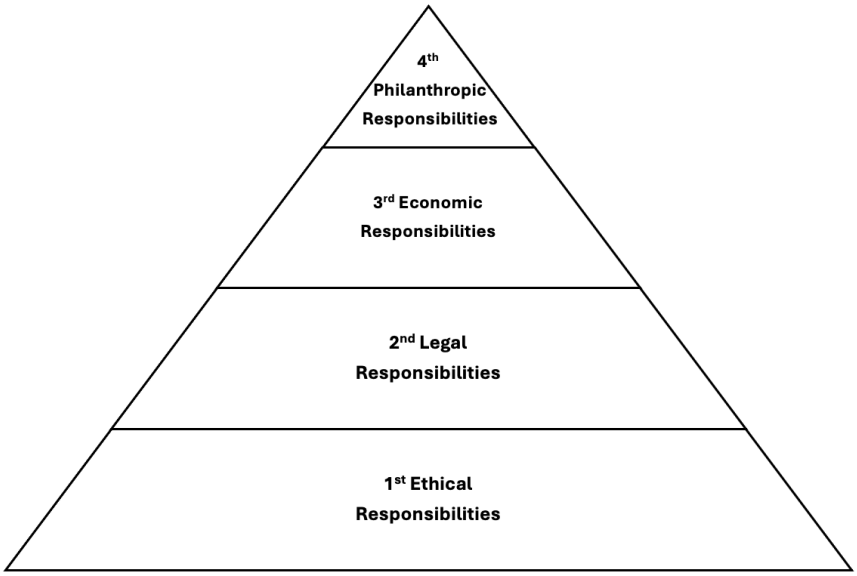

Figure 2. Proposed amended pyramid of CSR (Adapted from Baden, 2016, p.11)

In response to these criticisms, a new CSR pyramid has been developed, one that brings a more current view of what is now expected of companies in terms of accountability to its stakeholders. This new pyramid places ethical obligations first and foremost and means businesses must abide by morality and not harm society. The legal obligations go next, because of course you need to recognize that following laws is neither final nor effective in forcing companies to act ethically. Economic responsibilities are the third priority, which means that profit should only be made after all ethical and legal responsibilities. The shapes relate to the philanthropic responsibilities that sits at the top of the pyramid, indicating that giving back to society through a business should be viewed more as a bonus and something that a business should not see as core part of its responsibility. This shift is an indication of how corporate responsibility is changing, where there is an emphasis on ethical behaviour and ethical use of power before the goal of profit itself (Baden, 2016, p. 10-11).

Alternative theories also explain the underlying motivation for corporate engagement in CSR, as well as how corporations react to community social demands.

2.3.3 Stakeholder Theory

Stakeholders, according to Freeman (1984), those who contribute to a company's success and whom a company needs to survive. Stakeholders are any individuals or groups that can affect

or be affected by a company's mission and decisions (Cordeiro & Tewari, 2015, p. 835). Freeman describes a stakeholder as "any group or individual who can affect or is affected by the achievement of the firm's objectives." This gets to the complexity of stakeholder relationships as different groups often have different and sometimes opposing expectations (Fernando & Lawrence, 2024, p. 157).

Time and time again, we have seen scandals involving multinational corporations where profit was the priority rather than ethics. Such scandals, and financial crises too, have shown that these companies act in ways that have far-reaching effects on their stakeholders around the world. This challenge led to the development of stakeholder theory, which can be described as an attempt to reconnect business success with ethical responsibility (Parmar et al., 2010, p. 404).

There will be four approaches to this; stakeholder theory which argues that different stakeholder groups expect different things, and organizations have the responsibility to address them all instead of only focusing on shareholder interests as suggested by traditional theories. To satisfy this duty, however, management must act in ways stakeholders deem meaningful and disclose information in a manner stakeholders view as relevant. Accountability is important because it serves the process of ensuring organizations need to communicate their financial and non-financial data with those that affect and are affected by the organizations (Fernando & Lawrence, p. 158-160). It plays a crucial role within this framework because it offers reliable cost and benefit information to internal and external decision-makers facilitating well-informed decision making. Externally, investors use accounting data to seek stock price guidance and banks for lending risk evaluation. Within an organization, accounting informs decisions throughout the value chain, including sourcing, pricing, marketing, and after-sales support. As a result, even corporate responsibility decisions can be weighed in terms of where their costs and benefits lie in relation to the company (Sprinkle & Maines, 2010, p. 448).

There are generally two main perspectives of stakeholder theory: the ethical perspective and the managerial perspective. The ethical viewpoint is that all of an organization sits in fairness with respect to its shareholders. In this framing, companies are seen not only as profit-seeking organizations, but also as institutions with obligations to meet the needs and expectations of all stakeholders. But one of the fundamental difficulties in this perspective is striking a balance between the interests of different stakeholder groups, which are often at odds. The managerial

perspective, on the other hand, is much more grounded. It posits that organizations rank stakeholders according to their power over important resources. According to this perspective, the more critical a stakeholder is to a company's success, the more attention management will devote to satisfying their needs and expectations (Fernando & Lawrence, pp. 159–160).

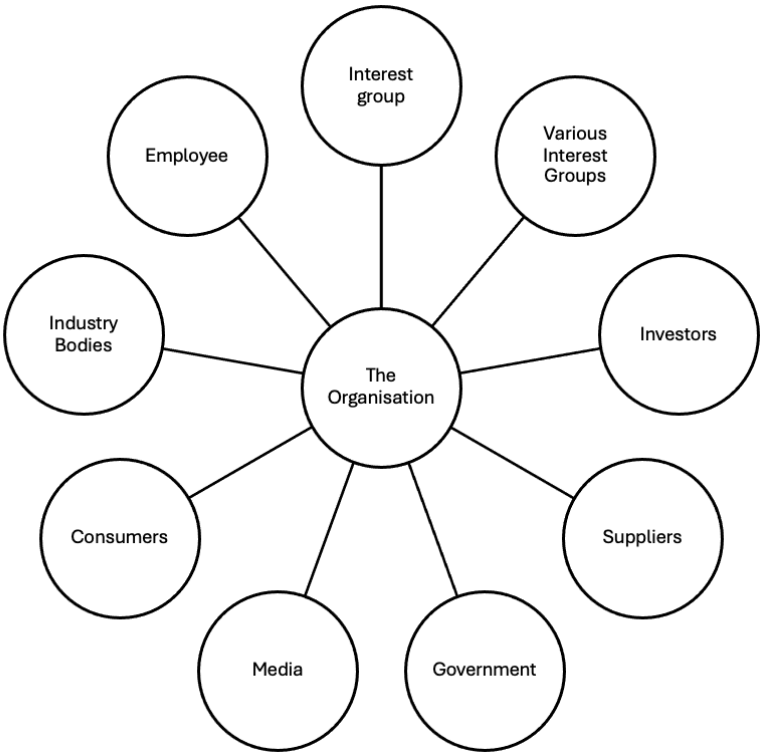

Figure 3. Stakeholder theory (adapted from Al Mamun et al., 2013, p. 41)

There are several reasons why companies act in a socially responsible manner. One reason often is to make them look better publicly. Certain companies commonly employ corporate social responsibility initiatives for the purpose of appeasing stakeholder groups, including non-governmental organizations (NGOs), a practice referred to as 'window dressing'. In addition, CSR yields concrete advantages as well. Well-executed, it may attract, motivate, and keep employees and it can be influential among consumers who value businesses that are driven by more than profit. CSR efforts can result in lower production costs and serve as a major component of a company's risk management (Sprinkle & Maines, 2010, pp. 446-447).

Stakeholder theory will help those businesses if they can understand that they make decisions that help them profit and improve the community. Ensuring a wider variety of perspectives and interests leads to better choices, which means greater potential flexibility in how a company operates and expands (Stern, 2018, p. 997).

2.3.4 Shareholder Theory

The shareholder theory is the opposite of stakeholder theory, it points that the main responsibility of the company is to maximize shareholder value. Its roots go back to the Industrial Revolution, when cottages gave rise to factories, and businesses morphed from small, family-run shops into large, publicly owned corporations with diffuse shareholders and professional managers. This transition influenced the manner in which companies were governed. It established an innovative method of corporate decision-making process and financial strategy (Idowu et al., 2020, p. 2).

Shareholder value maximization became the dominant corporate norm when economist Milton Friedman argued for it in the 1970s. He argued that a business's only obligation is to maximize its profits, as long as it is doing so legally and morally. Friedman asserts corporate executives act as agents of shareholders, and their obligation is to do what's in the best financial interest of the owners. He believed that investing in social or environmental causes, unless they contributed to profits, violated this responsibility because it diverted resources away from shareholder returns (Carson & Public Interest Enterprises, Inc., 1993, pp. 3–6).

Economic efficiency is the other key argument for shareholder theory. According to Friedman, businesses pursuing profit maximization leads to economic growth, creation of jobs, innovation, and ultimately the good of society. From this point of view, CSR is not required since free markets automatically distribute resources where they are most efficient (Carson & Public Interest Enterprises, Inc., 1993, pp. 14–16).

Even now, the basic idea of shareholder primacy remains powerful, arguing that managers should prioritize shareholder returns and inheritance over the interests of other constituents such as employees, suppliers or society at large. This model has come under increasing criticism, however, for being too limited, as it does not take into account the non-financial

objectives that shareholders and corporations alike may have, including responsibility towards society (Idowu et al., 2020, p. 1).

Many scholars consider the shareholder theory to be antiquated and driving short-termism and corporate avarice. Critics argue that shipping benefits only to shareholders leaves out key stakeholders, people who are integral to the well-being of a company. Proponents of stakeholder theory, such as Freeman (1994) and DesJardins & McCall (2004), argue that firms must act in the interest of all stakeholders, not just shareholders (Tse, 2011, p. 53). Furthermore, short-sighted management motivated by shareholders leads managers to favor short-term-specific solutions such as cutting employment, at the expense of long-term corporate stability (Stern, 2018, p. 996).

Table 1. Shareholder theory versus stakeholder theory (Rausch, 2011, p. 141)

	Shareholder Theory	**Stakeholder Theory**
Corporate Philosophy	Profitability	Responsibility
Corporate Ends	Meeting shareholder goals	Meeting interests of all stakeholders
Long-term Corporate Objective	Shareholder utility maximization	Value creation for all stakeholders
Stakeholder Interests	Means	Ends and means
Social Contribution	Self-interest seeking	Collective serving

Shareholder theory has been the dominant academic and business theory for the last 40 years. This suggests that agency is a critical driver of its hegemony. This theory presumes that managers, except when they are provided with the right incentive and monitoring mechanisms, do not necessarily pursue the shareholders' best financial interests. That is, supporting of managers or similarly harping upon the excessive overlap of goals between shareholders and managers are needed in addition to the firm-perfected machine perspective. This is exactly the type of thing shareholders have paid time and money to prevent shareholders also spend the time and money to monitor management and provide the incentive mechanisms to ensure that management decision-making will not tend to fall into collusion (Tse, 2011, p. 52).

2.3.5 Agency Theory

The agency theory is tied closely to study of the shareholders theory. (Jensen & Meckling, 1976 , p.308) introduced the agency theory, which provides a theoretical framework for understanding the difficulties in aligning shareholder and managerial interests. In a firm, the shareholders (principals) hire the managers (agents) to take decisions on their behalf to run the firm. Nonetheless, separating ownership and control can lead to problems like a misalignment of the interests of shareholders versus those of managers, who may prioritize personal goals like increasing compensation or personal adaptation of the firm over maximizing shareholder value.

The core purpose of corporate governance is to ensure that companies are run in a way such that it serves the interests of their shareholder while minimizing the unnecessary burden on the company. Based on the agency theory, shareholders (owner) delegate the operations of a company to managers. But because managers don't own the business themselves, there's a danger that they could pursue their own interests for example by raising their salaries or exercising more power by setting up divisions rather than maximizing shareholder value. Companies install corporate governance mechanisms to avoid this type of conflict. They include board oversight, performance-based compensation and financial audits, all of which help keep managers accountable. This is geared towards maintaining transparency, ethics and alignment with the interests of the shareholders in decision-making, which decreases the probability of mismanagement (Fama & Jensen, pp. 313–315).

According to the agency theory, firms that disclose sustainability information may be perceived by the market as "window-dressers" or "greenwashers", because they can use such information to influence the perceptions of their corporate legitimacy. Thus, we argue that firms with more severe agency problems are less likely to report sustainability initiatives in transparent and honest ways (Zhang et al., 2024, p. 2).

2.3.6 Trade-Off Theory

The trade-off theory provides a different perspective on the relationship between ESG initiatives and corporate financial performance. This implies that pursuing ESG principles

inevitably incurs extra costs and may damage near-term profitability. The requirements for obtaining high ESG scores can involve substantial expenditures that can negatively impact a company's cash flow in the short-term. While it is great for sustainability, reducing some of these forces can be expensive in the short term. However, there are ways to account for this cost.

Kraus and Litzenberger had established the Trade-Off theory for the first time in 1973. They introduced a model in which firms optimized their capital structure by balancing the tax advantages of debt financing with the costs of bankruptcy. They demonstrated that the effect of leverage on firm value is non-linear due to the presence of corporate taxes and insolvency risks (Kraus, 1973)

In the years that followed, much attention on this theory prompted many researchers to explore whether making sustainability part of corporate strategy results in superior long-term performance. For example, Eccles, Ioannou, and Serafeim performed an analysis in 2014. They matched 90 "high sustainability" firms (that adopted environmental and social policies before 1993) with 90 matched "low sustainability" firms. The teams collected data from thousands of companies worldwide and discovered that sustainability-focused firms have markedly different governance structures, stakeholder engagement practices, long-term orientation, and non-financial measurement systems. Their findings lend support to the logic of Trade-Off theory: while sustainable practices might incur greater short-term costs (e.g. expense on emissions reduction or stakeholder relations), they allow superior long-term financial performance, whether measured through returns on stock exchanges or the accounting estimates of ROA and ROE. Furthermore, these firms attract long-term investors and report more often on the future-oriented goals reinforcing the perception that integrating ESG is a strategic trade-off (Eccles et al., 2014).

In 2021, another study was performed by Azmi and some other researchers. They studied the correlation between ESG practices and bank outcomes in developing economies. The authors found a non-linear relationship between ESG engagement and bank value. Moderate ESG investments drive performance by promoting cash environments, efficiency and lower cost of equity, whereas excessive ESG spending creates diminishing returns (Azmi et al., 2021).

Finally, the trade-off theory revealed that ESG needs to be seen as an investment rather than a pure ethical consideration, and that performance outcomes depend on the way in which firms attempt to balance ESG benefits with resource constraints.

2.3.7 Legitimacy Theory

Legitimacy theory is one of the most frequently referred framework in social and environmental accounting (Tilling, 2004, p. 3). It helps illuminate how organizations pursue social legitimacy as a means of validating their existence and action. Named the legitimacy theory, businesses should constantly align their values and actions with the expectations of the society that they formed parts of, in order to be regarded as legitimate (O'Donovan, 2002, p. 345). From this perspective, organizations are embedded in a larger social system and have no automatic entitlement to resource. They need to establish their legitimacy and defend it with sceptical dialogue.

Legitimacy theory is based on the notion that organisations operate within a so-called "social contract", which essentially means an unwritten agreement whereby society has certain expectations about how corporate entities would behave. When a company meets these expectations, it is generally considered to be legitimate. Corporate disclosure is one of the main ways businesses manage legitimacy. Reporting social and environmental company data influences the public perception, reinforces the social license to operate (Deegan, 2019, pp. 2310–2311). This means environmental disclosures have to be true in the same way people strive to tell the truth about their environmental performance in everyday life. However, because it can often be difficult to measure environmental performance, the credibility and quality of these disclosures are of vital importance to determine how they will shape stakeholder perception (Alrazi et al., 2015, p. 47).

Legitimacy theory is generally categorized into two main perspectives. The first examines why companies choose to adopt sustainable and responsible business practices and how they communicate these actions internally and externally. Individuals evaluate a company's legitimacy in three ways: pragmatic, moral, and cognitive legitimacy. In Pragmatic legitimacy, the assessment here focuses on if a company's behaviours and practice results in tangible benefits for itself and its stakeholders (Thomas & Lamm, 2012, p. 193). Put simply, people

tend to be more on board with a company's sustainability measures if those measures lead to things like lower costs, less of a chance of getting sued, a better reputation, or a stronger brand. In other words, as long as people feel like they are deriving some sort of benefit from a company's activities, they will tend to view it as legitimate. Moral legitimacy, alternatively, concerns if an organisation's practice is consistent with social values and ethical expectations (Palazzo & Scherer, 2006, pp. 72–73). While pragmatic legitimacy is a product of self-interest, moral legitimacy is about doing "what is right," even if there's no immediate financial benefit. It is influenced by the public discourse and reasoning of the society on what actions or practices would be acceptable and warrant support. Cognitive legitimacy refers to how understandable and familiar a company's actions are. A company's sustainability efforts are more likely to gain acceptance when they are in line with the way people already view business and social responsibility. When something fits the contours of something else that makes sense, it tends to go less questioned. Awareness of these three types of legitimacy provides insight into why companies promote their sustainability efforts, not only to investors but to society at large. This indicates that companies are not only interested in profit but also care about the appearance of ethics, practicality and social conventions (Thomas & Lamm, 2012, pp. 193–194).

The second variant of legitimacy theory is in what context legitimacy is "playing" in, this too can be segregated to two categories. The first type is called the 'Institutional Legitimacy Theory', which is an overarching, macro-level perspective. It looks at how large systems like capitalism or democratic governance, gain acceptance in society. From this viewpoint, legitimacy and institutionalization are two sides of the same coin and organizations have greater power as they become more embedded in society, aligning themselves with societal norms. The second kind of legitimacy is organizational level legitimacy. Legitimacy here is not what a company possesses by default, but something it needs to earn anew daily by gaining the blessings of crucial elements in the society. Legitimacy acts in the same way as any asset would, as one would do with the funds. It is crucial for a company's performance and operation (Tilling, 2004, pp. 3–4).

It is fact that legitimacy theory can be used as a tool itself, this is also strategic for organizations. Research shows that businesses with a higher degree of public visibility are more aware of managing their corporate image, thus, they exercise better practices for sustainable reporting online and in annual reports. This indicates that activist firms use legitimacy theory as a tool to conform to societal norms and reduce public scrutiny (Branco &

Rodrigues, 2008, p. 699). Furthermore, prior research has shown that firms enhance their corporate social responsibility in response to environmental disasters. Citing the legitimacy perspective, they refer to specific events among those critical events given the above example, e.g., oil spills, gas explosions, etc. These kinds of events can attract heightened attention from both shareholders and other stakeholders, prompting companies to engage more actively in CSR initiatives to maintain or restore their legitimacy (Darrell & Schwartz, 1997, pp. 127–128).

2.3.8 Institutional Theory

This theory first started by the two important authors: Ernst Meyer and Brian Rowan. They contend organizations are best understood as following widely accepted rules, norms, and practices of modern society. Oddly, these rules don't always lead to greater efficiency in organizations. Instead, they work more like myths, allowing organizations to establish legitimacy and stability. This concept gives rise to the idea of 'Institutional Isomorphism', which is the phenomenon where organizations in the same industry or field become increasingly similar over the time (Meyer & Rowan, 2025, pp. 343–345). This process takes place through which three main ways. Coercive isomorphism is the first type, and it happens when organizations respond to pressure from other institutions that they rely on or the expectations of society. This pressure is either formal (in the form of regulations) or informal (in the form of cultural norms). A second mechanism, known as mimetic isomorphism, occurs when organizations imitate others, particularly in times of uncertainty. When companies are uncertain of technologies, objectives, or market conditions, they tend to copy what others are doing. The last one, normative isomorphism, springs from professionalization. Which means that organizations tend to become more and more alike, not necessarily as a result of competition, but mediated by similar professional standards, education and industry norm (DiMaggio & Powell, 2025, pp. 150–153)

While social institutions influence managerial choices in many ways, much research begins with the assumption that institutions fit cleanly onto types that impact outcomes in discrete ways. To explain how these institutions influence organizational behaviour, W. Richard Scott (1995) proposed a framework that outlines three pillars that institutions exert over organizations and individuals that they control. Cognitive, normative and regulative pillars are different aspects through which institutions impact behaviour (Trevino et al., 2008, p. 118).

Shared ways of thinking are the focus of the cognitive pillar. It notes that members of a society tend to develop shared views regarding what is considered "normal" or accepted. In other words, a country's institutional setting is determined by common knowledge and beliefs. As time progresses, organizations begin to adopt socially acceptable behaviours, resulting in institutional isomorphism in which they are conforming to cultural norms. The normative pillar deals with the social expectations, norms, values, and beliefs that inform how people view the world and what is considered appropriate or "good" in a particular society. It influences behaviour by way of audience expectations for how people and organizations should behave. This alone gives rise to certain shared beliefs and values. By contrast, the regulative pillar derives from explicit rules, laws, and policies that regulates behaviour through injunctions. These regulations are employed by governments and institutions to establish compliance, using legal consequences or incentives (Osinubi, 2020, p. 577). Over time regulation may even change behaviour and become the norm. These three pillars aren't independent, they influence one another. For example, a formal legal obligation can become a social norm. Deeply embedded, social expectations become so natural over time that people do not even question them (Kim et al., 2013, p. 2582).

The institutional theory associates CSR with societal values and norms in which a business exists. That is to say, managers are often motivated to make decisions that conform with social expectations as they want their organisation to be perceived as legitimate and reputable (Fernando & Lawrence, 2014, p. 165-166). This theory also disputes the notion that businesses exist solely for the purpose of producing goods and services. It sees organizations not just as economic systems, but also as social systems, shaped by cultural norms and expectations. This not only pressures the companies to maintain certain standards of corporate governance but also makes them act ethically and socially responsible (Al Mamun et al., 2013, p. 44)

This means organizations choose to practice sustainable development just because they want to have social acceptance. Indeed, more and more firms are attempting to achieve legitimacy and gain closer ties with stakeholders by signalling efforts toward environmental management. They do so through energy management, carbon emission reduction, and transparent environmental reporting, among other actions. At the heart of these corporate environmental strategies are the institutional pressures they face. Such influences tend to form a top-down diffusion approach that drives sustainability practices across sectors. On the one hand, society sets up the parameters under which businesses operate based on their sustainable management

and at the same time companies do not simply roll out the trends, but develop their own objectives and tools and ways of environmental management (Gunarathne et al., 2021, p. 834).

2.3.9 Resource-Based View Theory

Resource-Based View theory (RBV) provides a concurrent internal view regarding the unique resources and capabilities that a firm possesses. Rather than considering firms simply as units that react to their external environments, RBV considers the strategic management of resources that exist within the firms or systems as potentially the most critical source of sustained competitive advantage. This theoretical lens reconfigures the analysis to focus on firm-level resources and capabilities, providing a platform from which to consider how firms may develop greater distinguishing features in more complex and dynamic contexts.

In 1984, Wernerfelt introduced the Resource Based View theory, focusing on the resources of firms rather than only on the products they make and the industry they represent. A company's resources can be defined as tangible or intangible forms of assets including brand names, proprietary technologies, skilled personnel, or an organizational culture. The valuable and hard-to-imitate ones can act as sources of competitive advantage. As a result, Wernerfelt contends that strategic choices should center around the acquisition and development of these resources, as they underlie sustainable profit and strategic advantage. He further states that first-movers advantages are often the product of early investment in critical resources that rivals cannot easily imitate or afford (Wernerfelt, 1984).

A few years later, Barney further developed the RBV theory by specifying the conditions that must be met in order for certain firm resources to lead to sustained competitive advantage. He described resources as all assets, capabilities, processes, and knowledges controlled by a firm, that enable it to implement strategies that improve efficiency and effectiveness. To provide sustained competitive advantage, according to Barney, the resource must be valuable, rare, inimitable and non-substitutable. This is called the VRIN framework. Valuable resources enable firms to capitalize on opportunities or neutralize threats; rarity means few competitors have them; inimitability means the resources face high barriers to replicate (e.g., nonequivalent resources that are imperfectly mobile owing to factors like unique history, social complexity, or causal ambiguity); and non-substitutability means no strategically equivalent resources

exist. But it's not just about having the resources, firms need to be structured correctly to really tap into their potential (Barney, 1991).

These VRIN characteristics sheds light on how firms can use their intangible resources (e.g., ethical culture, stakeholder relations, and reputation) to navigate the ESG and CSR terrain, resulting in financial performance and competitive advantages sustained over time (Barney, 1991). In 1995, Hart extended his framework and explored environmental aspects by introducing the NRBV as a strategic framework for companies grappling with sustainability challenges. Competitive advantage in the 21st century increasingly hinges on capabilities having to do with managing natural environment and social responsibility. The NRBV includes three interrelated strategic capabilities: pollution prevention, product stewardship, and sustainable development. In particular, these capabilities closely align to ESG principles such as efficiency, stakeholder engagement and long-term societal impact. As it has been pointed out by the author, qualified environmental strategies can transform rare, valuable and non-imitation resources, converting them into what has been defined by RBV framework as the sustained competitive advantage (Hart, 1995).

2.3.10 Triple Bottom Line

The term triple-bottom line reporting was coined in 1997 by John Elkington. According to W. Richard Sherman, it examines a company's financial performance, but it also considers a company's ecological and social performance as well (Jensen & Meckling, pp. 673–675). This theory of change captures these three elements across its 3 pillars: Profit, People and Planet. Sustainable however is all three, and interconnected completely (Księżak & Fischbach, 2018, p. 99).

While profit is a must for any corporate to survive and grow, CSR emphasizes the "responsible" part. Money is not the only thing that matters. Most people feel that businesses should earn a profit by default. Uddin et al. (2008) also frames the economic dimension of CSR beyond the shareholder value. That's what includes how a company's actions impact the local community as well as other stakeholders. Socially responsible businesses use their resources in an effective way and every dollar you spend will help them to practice environmental sustainability, only contributing to eventual cost reduction. Economic

prosperity is closely correlated with expired societal well-being. These are businesses that support fair wages, local economies and responsible business that work to invest in the overall health of the economy. In addition, transparency in financial and CSR reporting also strengthens the level of trust for the business from stakeholders (Księżak & Fischbach, 2018, p. 100).

At the heart of every company are its people. Social CSR is centered on improving living standards and finding common ground between the corporate world and communities. This is particularly important for small and medium enterprises (SMEs), which are more likely to employ people locally. SMEs are facing double responsibility, as being a part of the community, their employees are also a part of the community. They create jobs, and they fix local problems. But those who make up the local community can also include some people who live outside the immediate area. This includes the businesses, suppliers, and all parties impacted by or impacting the organization. To benefit these stakeholders, businesses should invest in fair-paying wages, ethical working conditions, and skills development activities. Companies are the fundamental building block of our society; without companies, there would neither be employees nor customers nor even supply chain partners, and this is what makes social responsibility an inseparable part of the way companies operate. A responsible enterprise believes in the triple bottom line and does not promote exploitation, child labour and low pay structure. Others have scandals related to subcontractors breaking labor laws, revealing the need for closer scrutiny. And there is good news as well, more and more enterprises are focused toward social good and many are giving back a proportion of their income to society (Księżak & Fischbach, 2018, pp. 101–102).

Like people, businesses are tenants on our planet, and as such they have a duty to care for it. If they go on polluting recklessly, if they are exploiting resources recklessly, they're the ones who in the end will get hurt. Business sustainability is a necessity since it ranks among the sectors that are the most hostile to the environment. So how can businesses be more eco-friendly? At best, this business is ironic, though at least the top rung would be in selling services and products that leave no negative carbon footprint, but such a lifestyle is not always attainable, unfortunately. One final note, although technology will assist in driving emissions down to zero, they cannot be completely avoided in some sectors, like automotive. Nevertheless, every type of company could easily take actions to lessen waste and energy consumption," Mullerat (2010). Other companies reduce their footprint by minimizing water

usage and power, like unused light-switches. Learning to do it sustainably out there is not just morality, it's money. The long-term sustainability may also allow companies to reduce costs and streamline operations. Moreover, data about a company's environmental impacts are generally easier to quantify than information about the social benefits, so progress and improvement in CSR policies tend to be easier to measure (Księżak & Fischbach, 2018, p. 104).

The triple bottom line is a hugely popular CSR framework, but it also has its critics. Also, it is criticized for its only being a rather small scale, not reflecting all relevant components of CSR. There is still no one size fits all framing model applicable to CSR, the triple bottom line however remains a useful and widely considered model. Besides encouraging long-term profitability, it provides the companies tangible framework to measure the impact on profit, people and planet, that help implement the sustainability on their business operations (Księżak & Fischbach, 2018, p. 107).

Despite remaining a cornerstone of corporate sustainability understanding, the very broadness of TBL has led to a more systematised and quantified approach to corporate performance: Environmental, Social and Governance (ESG) performance. While TBL remains as a theoretical guideline to follow, ESG has become a measurable metric through which businesses and investors can evaluate corporations in a systematic way. ESG performance, in short, has become one of the main inputs into financial decision making as investors look for hard evidence of a company's long-term costing. In teaching accountability, transparency, and quantifiable impact to management, TBL is yielding a principle, if not an imperatives-based ESG, where sustainability is built in to the very guts of the business, as opposed to a stand-alone CSR initiative. ESG reporting frameworks help companies measure, benchmark and manage their social and environmental impacts in ways that align with social expectations of governance and financial performance (Crace & Gehman, 2023, p. 2023).

2.3.11 Why Engaging in CSR ?

Most CSR models (i.e., the corporate social performance model; Wood 1991; Wartick and Cochran 1985) and theories (i.e., stakeholder management; Freeman 1984) traditionally advise companies to engage actively in CSR and manage external social issues effectively. Given this

perspective, businesses cannot simply comply with institutional pressures for legitimacy (in this case referring to legitimacy via CSR). From the above discussion, we can see that business not only need to comply to the institutional pressures for legitimacy but also develop CSR which purely aims to build legitimacy (Beddewela & Fairbrass, 2016, p. 506).

The benefits of CSR tend to naturally parallel the reasons companies pursue it. We treat these benefits as cash inflows to the company, or cash outflows avoided. First, beyond tax deductions from cash and product donations, local, state and federal agencies often award tax credits for CSR and sustainability initiatives. And such credits and incentives can be measured ex ante in an easy way and require a certain familiarity with applicable laws and regulations. Moreover, companies often enjoy “free” publicity due to CSR. Additionally, as previously discussed, this concept often serves as a tool to recruit, retain, and motivate employees, as mentioned above (Sprinkle & Maines, 2010, p. 451).

2.4 ESG

2.4.1 Origin and Evolution of the Concept

The roots of ESG investing are in Socially Responsible Investing[1] (SRI), which predates the formal ESG term. The investment decisions of some organizations used be included in their exercise of corporate social responsibility (CSR) and philanthropy; a trend that began from the 19th century, more so among faith-based organizations (Eccles et al., pp. 576–577). But as we approached the new millennium, matters such as sustainability, climate change, human rights and risks of governance became more and more prevalent, which in turn led to an institutionalization of the issues into investment decision making (MacNeil & Esser, 2022, pp. 10–12).

Historical events and social movements over the course of the 20th century such as the Vietnam War, the civil rights movement, the environmental movement, women's rights advocacy gave rise to values-based investing. Investors motivated by political considerations aimed to use their capital to catalyse social change by favouring businesses that aligned with their values and by avoiding businesses that undertook controversial practices. A high-profile example of this approach was the divestment from Apartheid South Africa, when global institutional investors refused to invest in businesses in the country. One was the Ethical Investment Research Services Ltd. EIRIS in London, which the waste of/investment became the basis of responsible choice in churches, charities and NGOs (Eccles et al., pp. 576–577).

The 1980s were a pivotal era however, as sustainability grew increasingly relevant to corporate externalities and important for academic and regulatory discussions. The Brundtland Report of 1987 was key in articulating its concept of sustainable development, introducing the Triple Bottom Line (People, Planet, Profit). Since its origins, this idea connected economic sustainability with environmental and social impact and set the stage for what will later become ESG. By the 1990s it had evolved into a risk management idea that was closely connected to

[1] Socially responsible investing (SRI), also known as social investment, is an investment that is considered socially responsible due to the nature of the business the company conducts. A common theme for socially responsible investments is socially conscious investing. Socially responsible investments can be made into individual companies with good social value, or through a socially conscious mutual fund or exchange-traded fund (ETF) (Investopedia)

financial performance and investment strategies. While CSR described a set of activities pertaining to corporate social responsibility within an entity, ESG emerged as a portfolio measure that was intended to calculate financial risks surrounding environmental, social, and governance factors (MacNeil & Esser, 2022, pp. 12–14).

While investors had been practicing SRI for decades, the term ESG did not come into existence until the early 2000s. The term emerged in its first official use in a 2004 United Nations Global Compact (UNGC) report entitled "Who Cares Wins – Connecting Financial Markets to a Changing World.". This report originated in an initiative of the former UN SecretaryGeneral, which asked 20 of the large financial institutions (including BNP Paribas, HSBC, Morgan Stanley, Allianz SE, and Aviva PLC) to devise suggestions on how to embed environmental, social, and governance rends into asset management, securities brokerage, and financial research (Eccles et al., pp. 576–577). This report signified a turning point in encouraging corporations and investors to evaluate businesses based on environmental sustainability, the social economy, and ethical governance (Singh, 2023, pp. 1–2).

In that realization, multiple groups worked to develop ESG reporting frameworks in order to standardize how companies reported their practices related to sustainability. One of the earliest was the European Financial Reporting Advisory Group (EFRAG), followed by the Global Reporting Initiative (GRI), the International Sustainability Standards Board (ISSB) and the Sustainability Accounting Standards Board (SASB). Set by finance groups, these standards required business to rate, report and improve their ESG performance, effectively institutionalising ESG into the heart of corporate governance and investing. The truth is that ESG was only put on the global agenda in the last decade as big ticket global problems like increasing crises, climate change, economic uncertainty and social unrest began to dominate headlines. These challenges have drawn attention to the necessity of a more systematic incorporation of environmental and social considerations in business and financial decisions (Singh, 2023, pp. 1–2).

ESG, over the years, came to be the predominant paradigm, influencing corporate governance and financial regulation across the globe. The financial sector embraced ESG, leading to the development of ESG metrics, ratings, and regulatory frameworks, reinforcing the idea that sustainable business practices could drive long-term financial returns. CSR was often criticized for being too vague and unenforceable, whereas ESG provided a more structured and

quantifiable method that was readily digestible to investors in assessing risk and opportunity (MacNeil & Esser, 2022, pp. 10–12) The growing desire to invest in ESG spurred a whole ecosystem of ESG data and reporting. Investors, regulators, and companies wanted standardized ESG metrics to evaluate corporate sustainability performance. But the ESG landscape is fragmented, with more than 100 ESG data vendors providing unique methodologies. More than 500 ESG ratings, 170 ESG indices(Abeysekera, 2022, p. 93), more than 100 ESG awards, and 120 voluntary ESG standards are estimated in reports making it difficult for investors to find their way in the market (Eccles et al., pp. 576–577)

ESG continues to evolve today as companies and investors come to appreciate its significance beyond financial performance. Though there are still some debates about its economic impacts and regulatory challenges. Its essential purpose is still clear: to facilitate sustainable and responsible business practices that contribute to a more ethical and resilient global economy (Singh, 2023, pp. 1–2). Investments in global ESG have surged from $18.3 trillion to $35.3 trillion between 2020 and 2021 across major markets like the United States, Europe, Canada, Japan, and Australia, amounting to nearly 36% of total assets under management. This grew even more due to COVID-19, which raised awareness of environmental and social risks, particularly their consequences for vulnerable communities (Institute of Korean Studies & Jun, 2023, pp. 59–61). Hence, ESG is also right now mostly pushed by investment companies (e.g. Blackrock, MSCI, Standard & Poor's) and no longer by regulators and individual states, or governments, or political groups. In addition, ESG criteria and ratings were viewed by CEOs and board of directors as an important thing to meet investor and keep its company's stock price. Consequently, a growing number of organisations are pushing to transform their business into environmental friendly outcomes to ensure satisfaction of consumers and stakeholders due to also being pressured by social media, and ultimately its stockholders (Dathe et al., 2022, p. 119).

2.4.2 ESG vs CSR

ESG is an acronym for Environmental, Social and Governance. It is a framework that is used to help structure sustainability topics. ESG spans a wide range of topics across its three pillars. It's a large theme that will affect every aspect of business in the years to come, from business model to supply chain and meeting legal obligations, to cost control and securing clients, staff, and capital. (Forvis Mazars, 2025). The impact of this trend is that more and more investors

get ESG factors into their investment evaluation process, so that ESG is becoming ever more important in terms of obtaining capital, both debt and equity (Deloitte, 2022).

CSR and ESG are both tools in supporting corporate companies and Non-Profit Organisations (NGOs), to build a more positive picture of them in the world and highlight their claim that they are making the world better, at least from a society point of view (Dathe et al., 2022, p. 135).While there is overlap between sustainability, CSR, and ESG, there are also major differences. Sustainability is the umbrella term, whereas CSR and ESG are the two streams (MacNeil & Esser 2022, pp. 10–12).

CSR is an ethical term related to responsibility of company, which is not only limited to business but also extends to society. Under the CSR responsibility, organizations are seeking building sustainable partnerships with community. ESG is a performance framework, based on either voluntary or mandatory reporting standards. They rely on the non-financial information given to either develop investment strategies or to engage with the company in order to progress with matters of concern in an area (Forvis Mazars, 2025). The emergence of ESG reflects a deeper shift in the way that corporate governance is understood, with sustainability perceived not purely as a moral requirement, but a financially-material consideration that influences investing and regulatory decisions (MacNeil & Esser, 2022, pp. 10–12)

Corporate Social Responsibility	Environmental Social Governance
• Self-regulations by companies; • Meaningful positive impact on customers, employees and public society; • Philanthropical non-measurable approach.	• Comparable quantifiable data and accountability over supply chain, employees, climate change and carbon footprint; • Measurable quantifiable approach to support Diversity & Inclusion in our society.

Table 2. Comparison of Corporate Social Responsibility and Environmental Social Governance (Adapted from Dathe et al., 2022, p. 135).

From a theoretical perspective, one of the key differences between CSR and ESG is the inclusion of governance as a separate category in ESG. Although CSR indirectly takes into account governance characteristics by addressing social and environmental elements, ESG

explicitly includes governance dimensions, which leads to a more comprehensive framework. A key difference is the way CSR and ESG quantify corporate responsibility. Traditionally, CSR is qualitative in nature and is based on voluntary corporate activities which are not subject to standardised measurement. ESG, on the other hand, is more qualitative, with hard criteria to measure how a company is doing. From a corporate perspective, ESG relates to the particular practices and criteria a firm is required to adhere to in environmental, social and governance aspects. CSR, however, is a more encompassing business model where such organizations take voluntary socially responsible steps ("Exploring the ESG Surge," 2024, pp. 234–238).

These approaches are often in tension with one another, and as ESG matures, this tension has only increased. With the rise of ESG, corporate governance and financial regulation are going to be even more important in defining sustainable economic models soon. The evolution from CSR to ESG represents a fundamental change from compliance-based corporate responsibility to an integrated, financially motivated approach to sustainability.

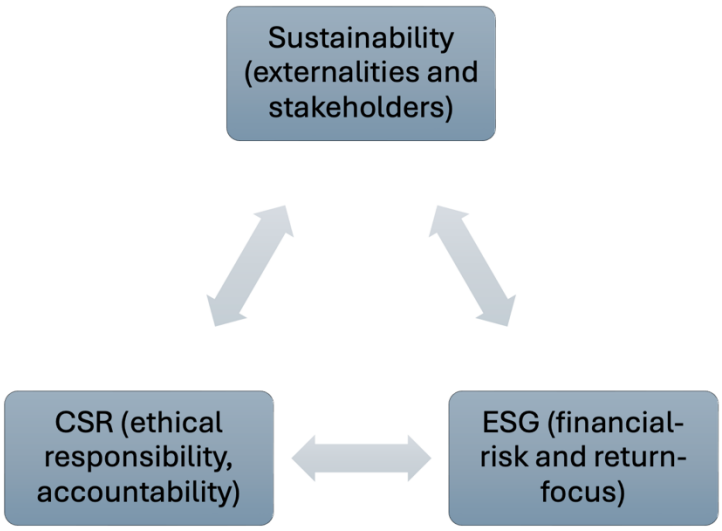

Figure 4. Sustainability, ESG and CSR (Adapted from MacNeil & Esser, 2022, p. 11)

CSR and ESG are connected, and CSR is considered a precursor to ESG, as it laid the foundation for responsible business practices. ESG as a framework adds onto CSR by quantifying and holding corporations to account for sustainable practices. CSR can often fall trap to issues such as greenwashing as it does not have a standardized assessment to judge

effectiveness. ESG, however, plays on the data-driven side of things which reduces the risk of this happening. Both frameworks focus on stakeholder engagement. However, CSR contains a wider range of groups involved: employees, communities and consumers while ESG supports more of an investor-oriented approach (Poznań University of Economics and Business & Kaźmierczak, 2022, pp. 281–283).

Figure 5. Timeline (adapted from MacNeil & Esser, 2022, p. 12)

There has been a significant move from CSR to ESG points in corporate sustainability reports. While the two concepts are both covering the idea of embedding sustainability at the heart of business practices, they do differ on motivation, implementation and comparison with each other. CSR, one of the dawn business philosophies relate to ethics, and responsibility by far it is positive approach enjoyed by all that delve into corporate accountability, and the well-being of a company of the society going beyond financial aspect of either. All along, this improved reputation and long-term performance, but it was company led, and no standardized metrics had been established. By contrast, ESG emerged as a framework instigated by investors to embed sustainability into financial decision making, as it relates to risk and return. Whereas CSR is self-regulatory, ESG is shaped by the financial markets as a disciplinary pressure for change (MacNeil & Esser, 2022, pp. 10–12).

2.4.3 ESG Criteria & Disclosures

Figure 6. The three pillars of ESG (adapted from Forvis Mazars, 2025)

The evaluation or rating of the E pillar focuses on measures that industries can drive but it becomes an essential method to ensure the sustainable functioning of a firm by pin-pointing environmental concerns. E pillar assesses a broader category of information regarding outputs like waste and emission, climate change and risk management (Senadheera et al., 2021, p. 5) (Senadheera et al., 2021). Resource use for example whether a company uses virgin or recycled material in its production processes, and how a company ensures that cradle-to-grave, the greatest percentage of material in their product is cycled back into the economy versus going to landfill. Companies are also supposed to be good stewards of water resources. The Environmental Pillar also covers land-use issues, such as deforestation and disclosures related to biodiversity. Companies also write about what positive sustainability impacts they may have such as impacts that can generate long-term benefits in business. This pillar is the most controversial and complex from a reporting perspective (Deloitte, 2022).

Under the Social Pillar, companies report on how their activities relate to employee development and labour practices. They conceal product liabilities of the safety and quality of theirs. They are also responsible for reporting on supply chain labour and health and safety standards and controversial sourcing issues. Corporations have to disclose at least on how they access underprivileged social groups to their products and services (Deloitte, 2022).

G, governance, is the set of practices, controls, and processes the company implements to internally manage itself, make good decisions, comply with the law, and address external stakeholder needs. The governance of every company should take place (Henisz et al., p. 1).

2.4.4 ESG Scores

LSEG has one of the most extensive ESG databases available in the industry covering 90% of the global market cap, across more than 870 different ESG metrics and a history of up to 2002. This dataset covers nearly 16,000 public and private companies worldwide. LSEG's ESG scores are intended to transparently and objectively assess a company's ESG performance, commitment and effectiveness relative to its peers, based on data reported by companies. It applies to 10 key themes which include emissions, environmental products innovation, human rights, shareholders, etc. The percentile rank scores are easy to comprehend (offered as percentages and as letter grades, from D- to A+). The scores are relative performance of ESG in all (LSEG, 2024).

Table 3. ESG scoring ranges and grades (adapted from LSEG, 2024)

Score Range	Grade
0.0 <= Score <= 0.083333	D -
0.083333 <= Score <= 0.166666	D
0.166666 <= Score <= 0.250000	D +
0.250000 <= Score <= 0.333333	C -
0.333333 <= Score <= 0.416666	C
0.416666 <= Score <= 0.500000	C +
0.500000 <= Score <= 0.583333	B -
0.583333 <= Score <= 0.666666	B
0.666666 <= Score <= 0.750000	B +
0.750000 <= Score <= 0.833333	A -
0.833333 <= Score <= 0.916666	A
0.916666 <= Score <= 1	A +

'D' score denotes weak relative ESG performance and inadequate degree of disclosure of material ESG information to the public. The 'C' score signifies respectably relative ESG performance and a moderate degree of transparency in the public dissemination of relevant

ESG material data. ‘B’ score denotes good relative ESG performance and above average level of transparency incorporating substantive ESG data publicly. LSEG (2024) states that ‘A’ score reflects a relative, strong ESG performance and an excellent degree of transparency in publicly reporting material ESG data (LSEG, 2024).

2.4.5 ESG Disclosures & Sustainability Reporting

Over the past 10 years, ESG issues have increasingly come into focus for different stakeholders, from consumers to employees to public interest groups and regulators. As a result, many companies have integrated ESG initiatives, held management roadshows to showcase their ESG performance, and integrated ESG disclosures into their annual reports (Khan, 2019, p. 103).

ESG disclosures are an integral component of sustainability reporting, which increases transparency on the way organizations manage their ESG responsibilities. Such disclosures allow stakeholders to judge a company’s environmental and social footprints. As organizations have begun to realize that practicing sustainability ensures financial health over the long-run, ESG disclosures have transitioned from voluntary to a central strategic priority (Singhania & Saini, 2023, pp. 520–521).

But ESG ratings are still complicated because there is no uniform definition or standardized reporting formats. Unlike credit ratings, the ESG scores are produced using a multitude of different methodologies, which is why there is such a wide discrepancy between the ratings agencies. Thus, a company's ESG performance can be measured in varying ways depending on the method used, complicating comparisons that are useful. Due to these inconsistencies, structured sustainability reporting is thus a necessary tool providing a more transparent and standardized view of corporate ESG performance (Billio et al., p. 1429).

The roots of sustainability reporting lie in the wider notion of sustainable development, which consists of three important pillars: economic sustainability, social equity and environmental protection. Economic growth through sustainability business model. Social equity explores fair labour, diversity and ethical governance, whereas environmental sustainability targets the minimization of businesses' footprint over natural resources and climate change (Singhania &

Saini, 2023, pp. 520–521). A sustainability report helps stakeholders understand the environmental, social and governance impacts of a company's activities as well as the related risks and opportunities, and evaluate a company's commitment to sustainability. An accountability mechanism to ensure stakeholders of a firm's good faith in tackling sustainability problem (PwC)

Globally, sustainability reporting is gaining ground rapidly. In 1993 only 12% of the top 100 companies in 52 countries replied to KPMG about sustainability reporting. Among the world's 250 largest companies by revenue, the adoption of sustainability reporting increased from 35% in 1997 to 96% in 2020. It further demonstrated that sustainability reporting is now commonplace practice among large corporations (Abeysekera, 2022, p. 1387; KPMG, 2024). This increasing importance has prompted regulators to work on formal sustainability reporting standards. For the Europe, they were introduced the European Sustainability Reporting Standards (ESRS) as an action of the EU Green Deal, requiring companies to disclose ESG-related data. On a global scale, The IFRS Foundation established the International Sustainability Standards Board (ISSB) to set a baseline standard for sustainability disclosure. This effort combines earlier frameworks such as the Global Reporting Initiative (GRI), the Task Force on Climate-related Financial Disclosures (TCFD), and the Sustainability Accounting Standards Board (SASB), shifting sustainability reporting from purely voluntary guidelines to required compliance in many jurisdictions (Wagenhofer, 2024, p. 2).

Financial reporting is generally a give-and-take game between investors and firms, providing information to investors but not directly affecting the firms' decisions while sustainability reporting is intended to steer corporate behaviour. The political and regulatory objective of mandatory ESG reporting is a push for firms to adopt sustainable business practices proactively rather than reporting on historical performance. As ESG disclosures become more regulated, businesses are obliged to embed ESG into core strategy (Wagenhofer, 2024, pp. 2-3).

2.4.6 Geographic Focus

ESG Finland is an amazing country for ESG principles. Backed by a long tradition of social welfare, open governance and nature stewardship, ESG is not a corporate fad here, it's part of the national DNA. 'In Finland, there is also an emerging, business–critical focus on ESG,

supported by both regulatory environment and citizen expectations for sustainability and ethical behaviour.

Finland holds a leading position in the line-up of the EU leaders in such an area of environmental, social, and governance strategy, bearing in mind being considered to be one of the ESG leaders in the European Union (Jílková & Kotěšovcová, 2023). The notion of sustainable development has been internalized in its culture, and the ESG in its business model has been accepted by its financial institutions (Rahi et al., 2022). Finland follows the Scandinavian civil law system, which has strong creditor and shareholder protection as well as legal enforcement. Government institutions enjoy a great deal of trust. Finland ranks amongst the countries with low corruption and bribery and relative ease to get a business set up. Sustainability is a concept embedded in Finnish culture. Finland is ranked 2nd places to 5th places with Denmark, Norway, and Sweden in the sustainability rankings of 128 countries. SRI in Nordic countries stems on a high level of institutional components while it is not based on maximizing its economic benefits. The earliest SRI activity in Finland goes back to 1999. They discovered, among other things, that Finnish SRI investors are more likely to invest in core SRI than in broad SRI. Yet sustainability reporting has been optional for a long time (Buchanan et al., 2025).

Finland aims for carbon neutrality by 2035 and will do so through emissions-free electricity low-emission transport, and sustainable construction (World Economic Forum, 2023). Finland's relatively low reliance on fossil fuels relative to other advanced nations has been a particular boon in the push for carbon neutrality. In fact, in 2021 fossil fuels accounted for just 36% of Finland's total energy supply, less than half as much as the average for International Energy Agency (IEA) members, which stands at 70%. This can mainly be attributed to Finland's high reliance on nuclear energy, which accounts for around one-third of the country's electricity. The country's main policies to achieve climate neutrality by 2035 are:

- Reaching nearly emissions-free generation of electricity and heat by the end of the 2030s ;
- Building a "resource-wise" and low-emission transport system ;
- Driving down carbon emissions in the construction industry ;
- Increasing energy efficiency of the existing building stock and transitioning toward zero-emissions heating.

Despite this bold ambition though, Finland is not without its challenges to ESG implementation. For example, its land use and forestry sector turned into a net emitter of carbon in 2021, largely caused by increased rates of harvesting and lower growth of forests, raising resultant net emissions of the country (World Economic Forum, 2023). Finnish consumers are positive about companies adopting sustainable practices, but that doesn't translate to ESG in consumer behaviour. While 63.16% of Finnish consumers prefer companies that make sustainable choices, only a very small percentage are willing to pay a significantly higher price for eco-friendly products (Shamsuzzoha & Fontell, 2024, p. 297)

Corporate governance is a critical component of Finland's environmental sustainability strategy. It has been pointed out that robust legal frameworks guarantee transparency and trust in institutions which helps integrate ESG in financial markets in the country. But even with the high level of ESG reporting, businesses in Finland continue to find it difficult to reconcile sustainability investments and financial performance. Whereas people governance issues of ESG are positively associated with financial stability, broader ESG investment negatively correlates with short-term profitability (Buchanan et al., 2025, Page 177).

What's more, the paradox of Finland's ESG leadership shows up in consumer-and business-behavior. While sustainability is promoted in the country, resource consumption is relatively high and only few consumers value carbon offsetting as a sustainability measure. Finnish organizations too are facing the challenge that ESG goals must become profitable and government regulations and financial incentives play their part in maintaining sustainability principles at companies (Shamsuzzoha & Fontell, 2024, p. 6).

The French approach to ESG integration offers lessons on legislation and on how institutional investors can be market movers. Over the last two decades, ESG has moved from market making to mainstream, helped along the way by mandatory disclosure rules, public sustainability ratings, and an accelerating focus on long-term responsible investing. On the basis of this activity, France is a particular interest for this thesis, as it has a well-established SRI market since the end of the 1990s.

In the European Union, it is the Corporate Sustainability Reporting Directive (CSRD) that lays down a minimum ESG disclosure framework for companies in all member states. Under the

current proposal, CSRD would apply to the 50,000 companies operating in the European Union. Companies with a minimum of 250 employees and €50 million in annual revenue are required to divulge hundreds of ESG data points, from the gender diversity of their boards to the biodiversity risks associated with their operations (Schwartzkopff & Nussbaum, 2025).

However, France goes further with its own national initiatives to regulate and promote sustainable finance. We can observe that significant amount of SRI funds was created globally from 1970 to 2014, and this phenomenon signifies a search for financial and social logics. Over the past twenty years, France, alongside Norway, the United States of America and the United Kingdom, has been both an early adopter of SRI as well as one of the most successful SRI markets. The evolution of the SRI markets in France exemplifies a positive transition toward sustainability within a particular institutional context that facilitates the elaboration of state finance's distinctive role in the financial marketplace.

There are two basic approaches that businesses take toward sustainability. The first is by rolling out their own voluntary initiatives, such as reducing emissions — but those are often in limited scope and can leave open the question of how serious they are. The other, and more effective, way is via regulation. Government policies or laws at the national or international level can incentivize companies to make real changes and move toward more sustainable practices. In France, this top-down approach makes particular sense because of the country's "state-influenced" economic structure. Unlike the United States, which is more market-driven and where the government plays a lighter role, France has a stronger tradition of government involvement. The state is not merely a rules enforcer; it's a state builder that seeks to shape the terms of the sustainability agenda and play a central role alongside businesses and investors (Crifo, Durand, et al., 2019, pp. 6-7).

The French government implemented two official labels to ensure that sustainable investments in France adhere to ESG standards. The SRI label is valid for generalist responsible investment funds—it consists either of excluding at least 20% of companies according to their ESG performance or of having a better portfolio ESG score than the market average. The TEEC (now Greenfin) label is more prescriptive: it only concerns green investments and only supports funds that manifestly serve the ecological transition, for example through financing in renewable energy, clean transport or water management. It also does not include fossil fuels, nuclear or other sectors (Crifo, Durand, et al., 2019, 22-23).

ESG has been riding high in France for a long time, but now it is caught between the country's current political polarisation which sees the President Emmanuel Macron facing both the far-right and the left ongoing social unrest and a challenging legislative backdrop. The international reputation of the country continues to be high. The politics is really racked with domestic disputes such as the issue of ESG (International Financial Law Review, 2024).

ESG factors have gained growing importance among corporate strategy and financial markets in Germany. As the largest economy in Europe, it's also key to pushing sustainable business practices throughout the European Union. The German government has played a proactive role in driving ESG disclosure by endorsing the EU's Corporate Sustainability Reporting Directive, and many large German firms and financial institutions are embedding ESG into their own value chain to satisfy both investor demands and climate objectives.

Germany has adopted civil law which provides greater power for the government to regulate corporate ESG behaviour in sharp contrast to common law nations such as the United Kingdom (S. Chouaibi et al., 2022, p.47).

Since the 2008–2009 financial crisis, the regulatory expectations of listed companies in Germany to incorporate CSR into their governance and reporting have continuously increased. These may involve such steps as sustainability-linked executive compensation, and mandatory non-financial reporting in management disclosures. Many companies, on the other hand, voluntarily adopt international frameworks such as the Global Reporting Initiative (GRI) and the German Sustainability Code, whereas the International Integrated Reporting Council (IIRC) framework has become increasingly used alongside (Velte, 2019, p.47).

Furthermore, since the introduction of the EU CSR Directive 2014/95/EU in Germany, large capital market-oriented companies have been subject to a requirement to report on sustainability. However, the scope of choice of reporting by companies is still open as they may adopt different (acceptable) frameworks, as well as design formats (Banke et al., 2022).

Table 4. OECD major countries' CSR regimes (Adapted from Crifo & Rebérioux, 2015 p.218)

Aspect	France	Germany	Finland
Latest ESG Law	*Grenelle 2*, 2010	*German Sustainability Code*, 2011	No specific ESG law; guided by EU directives and voluntary frameworks
Themes Covered	ESG	ESG	ESG
Mandatory or Voluntary?	Mandatory	Voluntary	Largely Voluntary (but influenced by EU CSRD for larger firms)
Scope	Companies with over 500 employees and €100M+ revenue	All companies and organizations	Large institutions mainly; sustainability is widespread but not enforced
Standards/Guidelines Used	GRI, ISO26000	GRI, EFFAS	GRI, EU CSRD, Finnish national guidelines
Verification Required?	Yes	Yes	No (generally optional)
Sanctions for Non-Compliance	No	No	No (limited enforcement)
ESG Rating Systems?	Yes	Yes	Yes (limited and evolving)
CSR Evaluation Approach	Binding	Non-binding	Non-binding
Governance Model	Partnership-based	Partnership-based	Partnership-based with strong public trust and institutional cooperation

As EU ESG leaders, Finland, France and Germany have different parts, built on their governance models, regulative systems, and common convictions. In a country like Finland, for instance, ESG is part of the national identity. While there is no dedicated ESG legislation, the country does closely follow European regulation, e.g., the CSRD. ESG in Finland is mainly voluntary but is widely adopted across sectors and industries, especially for larger organisations. Public trust, strict legal enforcement and low corruption contribute to a strong basis for ESG integration. Finland, which aims to become carbon neutral by 2035, is concentrating on clean energy, low-emission transport and sustainable construction. But there

are ongoing challenges, including forest-based emissions and a disconnect between consumer ideals and buying habits. And, while systems of ESG ratings exist, sustainability reporting is more or less voluntary, whereas the CSR approach is not obligatory, although it is deeply rooted in social nature.

ESG regulation is mandatory and state-driven in France. Early groundwork was laid with the "Grenelle 2 law" in 2010 for ESG disclosure, which was widened through the EU's CSRD. Reporting ESG data based on established frameworks (e.g. GRI, ISO26000) is mandatory (from 500+ employees, revenue >€100M+). For its part, France created its own sustainability labels, SRI and Greenfin, to guarantee transparency and ecological impact. There are no formal penalties for not complying, although it is subject to verification. The French model is compulsory and heavily influenced by the government, which is a reflection of the country's top-down style of governance.

Germany has a more structured but looser system. Germany offers a voluntary approach on ESG, complemented by legal action and also guidance through international standards such as GRI and EFFAS. Even with more focus on sustainability-linked governance, ESG practices are fairly common for many companies, particularly larger firms. As with France, verification is encouraged, but sanctions are not enforced. The German system is advisory rather than mandatory but carries significant weight, particularly because of Germany's economic size in the EU. CSR in Germany is based on partnerships, with companies voluntarily integrating robust reporting standards, but the reservation of freely selected reporting standards.

2.4.7 Impact of ESG Criteria on the Financial Performance

The transition from CSR to ESG reflects a difference in mindset as to how companies consider the relationship between sustainability and financial performance (MacNeil & Esser, 2022, pp. 19–20). Scholars, investors and corporate leaders have attempted to measure whether the integration of ESG principles has a stabilizing effect that improves financial performance or is a drag that drains resources and dents a company's bottom line. While ESG originated as a means of promoting sustainability, social welfare, and ethical governance, the financial implications of doing so have come to dominate modern investment approaches.

Unfortunately, the financial case for ESG is still thin on data. Some researchers have conducted a meta-analysis of more than 1,000 studies from 2015 to 2020. The findings revealed that:

- ESG had a positive effect on company performance in 58% of studies ;
- 8 % mentioned negative impact The ESG investing was considered as having a cost in the most of the cases ;
- 13% of all studies had no evidence of a positive link between ESG and financial performance ;
- 21% were qualified mixed, meaning that ESG impact is conditional on industry, regulation and firm strategy (Singh, 2023, pp. 3–4).

Increasing amount of literature supports this view, as shown in the cited study, and indicates that strong ESG practices can lead to increased financial performance for a company. Velte (2017) examines the link between Environmental, Social and Governance performance (ESGP) and corporate financial performance (FINP) based on a sample of 412 firm-year observations for major German-listed firms (DAX30, TecDAX, MDAX) in the period of 2010–2014. He collected ESG scores via Thomson Reuters Asset4, and he measured financial performance through accounting-based (Return on Assets – ROA) and market-based (Tobin's Q) indicators. Moreover, the regression analysis shows that the overall ESG performance score is significantly and positively associated with ROA. This implies that organizations with stronger environmental, social, and governance practices tend to demonstrate stronger internal financial performance, especially on profitability and efficient asset utilization. When examining the individual policies of ESG, they find that governance performance (GS) has a stronger and positive impact on ROA than environmental (ENS) or social (SOS) scores (Velte, 2017, p.176).

The study by (Saeidi et al., 2015) examines the indirect roles of three mediators (Reputation, customer satisfaction, and sustainable competitive advantage) on the CSR and how this one influences firm financial performance. The analysis employs structural equation modeling and is located on data from 205 Iranian manufacturing and consumer goods organizations. The findings reveal that although CSR is positively correlated with financial performance in the first stage, its positive result becomes insignificant when entering control variables. This means that the relationship between CSR and financial performance is indirect and fully mediated.

In this sense, (Rodriguez-Fernandez, 2016) measures CSR based on a Social Behavior Index, an index that contemplated four elements: (i) participation in the Global Reporting Initiative (GRI); (ii) inclusion in the Dow Jones Sustainability Index (DJSI); (iii) Good Corporate Governance Recommendations; and (iv) signing the UN Global Compact (GC). The financial performance is evaluated through three main metrics: return on assets (ROA), return on equity (ROE), and Tobin's Q. The results of the empirical analysis confirm the existence of a positive relationship between CSR and financial performance, supporting the hypothesis that "the social is profitable."

For this analysis, they used data from 93 banks in emerging economies from 2015 through 2018. They used ROA and ROE as key metrics to measure the financial performance and obtained their ESG scores from Refinitiv's Asset4 database. They find, in particular, that there is a positive and significant relationship between both environmental and social performance. That means that companies that takes care of its sustainability impact to the environment or its society, correspond to a potential improvement to financial performance, when variables ROE are considered as the performance indicator (Shakil et al., 2019).

Another analysis conducted by (Almeyda & Darmansya, 2019) examines the impact of ESG (Environmental, Social, and Governance) disclosure on the financial performance of real estate companies listed in G7 countries from 2014 to 2018. The primary measure of non-financial performance indicates that Bloomberg ESG scores are used, and then the relationship with accounting-based (ROA and ROC) and market-based (Stock Price and P/E ratio) financial performance indicators is swept through. The findings indicate that there is a statistically significant positive relationship between ESG disclosure and firm's accounting performance. Companies that are more transparent about their environmental, social and corporate governance practices tend to report better internal financial efficiency and top line.

The next study has been conducted using a sample of 159 firm-year observations from Indonesian publicly traded companies from 2012 to 2016. It explores the influence of ESG disclosure on firm performance, as proxied by ROE. Finally, these results indicate that ESG disclosure is positively and significantly associated with firm performance suggesting that higher transparency in sustainability businesses will further improve profitability (Triyani et al., 2020).

The study by (Yu et al., 2018) tries to find out if better transparency of ESG disclosure boosts firm value, based on a global database of 1,996 large-cap firms covering 47 developed and emerging markets for years 2012-2016. Instead of considering ESG performance itself, however, the authors look at how much ESG information is disclosed, using Bloomberg's ESG Disclosure Score, which measures the amount of publicly reported ESG information. In particular, ESG disclosure exhibits a significant positive impact on firm value in the early stage, which is in line with the thought that enhanced transparency alleviates the information asymmetry and agency costs. Yet, above an inflection point, too much ESG disclosure may prove to be counterproductive, hinting at diminishing returns or, possibly, a negative effect at high disclosure frequencies.

Yet it's becoming increasingly clear that the financial argument for ESG is present, even as some argue ESG is nothing more than a costly fee, not a value-creating strategy. Others question what ESG, or environmental, social and governance investing, has done for their bottom lines, and view the effort to comply with ESG standards as a regulatory morass that has the potential to divert resources from their business. But ESG proponents argue that the benefits outweigh the costs, including the chance for risk mitigation, goodwill, and human capital crafting (Singh, 2023, pp. 3–4).

For example, Chouai, Rossi, and Zouari (2021) studied a panel data of 154 non-financial firms over the period 2015-2020. They analyzed a panel data set for 154 non-financial firms from 2015 to 2020. They investigated the impact of corporate sustainability responsibility (CSR) on the implicit cost of capital of French ESG-listed corporations and concentrated on the effect of sustainability-related executive compensation. The findings support a strong and statistically significant negative relationship between CSR performance and cost of equity, lending further weight to the notion that a greater extent of CSR involvement leads to a lower perceived level of investment risk and expected returns by shareholders than those demanded by shareholders. This is consistent with the stakeholder theory, which suggests that firms that are socially responsible have more legitimacy and visibility that lead to reduced information asymmetry and agency costs (Y. Chouaibi et al., 2021).

Even in the time of Covid-19, a handful of scholars investigated the relationship between ESG and firm financial performance across the G20 countries. They also investigated whether the relationship is moderated by ESG performance. Measurements The researchers utilised 2016

2021 panel data and ESG ratings featured in the Thomson Reuters EIKON database and examined accounting-based signals (ROA, ROE) and one market-based financial signal (EPS). The data itself, as illustrated in all measures, unequivocally points to the wide-ranging, negative impact of the COVID-19 pandemic on financial performance. But in that timeframe, the picture of ESG's role is mixed, if not outright positive. While the authors claim that ESG practices can protect against the economic damage of crises, empirical evidence indicates that there exist positive and negative impacts of ESG performance on accounting-based performance metrics of performance like ROA & ROE (Al Amosh & Khatib, 2023).

Leveraging a 67- ICC cross-country and panel dataset from 2006 to 2015, (Lu et al., 2018) advanced a more nuance hypothesis: CSR activities have an inverted U-shaped relationship with FP in that CSR activities are harmful for FP in the short term, but beneficial for FP in the long term. The findings confirm this paradox. Through vector error correction modeling (VECM) and Granger causality tests, their findings indicate that CSR has short-run negative effects on financial performance (measured in revenue growth), and the later is reported as statistically significant.

From 2006 to 2021, (Abdulla & Jawad, 2024) studied the link between ESG scores and company performance for non-financial companies of MENA region. In particular, it sheds light on novel information about the moderation of the relationship through climate in the form of CO_2 emissions and the Global Climate Risk Index (CRI). Picking source of Refinitiv ESG data and employing a two-step analysis, the authors study the repercussions of ESG activity on three performance metrics, i.e., Return on Assets (ROA), Return on Equity (ROE) and Tobin's Q. The findings suggest a statistically significant negative effect of ESG on both operating (ROA) and financial (ROE) performance. This evidence suggests that ESG activities are predominantly perceived as being cost-driven investments, as predicted by the stakeholder expense theory and tradeoff theory. They both indicate that with social and environmental commitments, shareholder value will have to go down when not offset by sufficient financial returns.

In the study on Norwegian publicly listed firms during 2010-2019, financial performance is represented by a combination of the accounting-based (ROA) and market-based (Tobin's Q) factors. Therefore, this study is significant as it is among the early studies studying this link in the Norwegian context which is a country with significant focus on sustainability and social

responsibilities. This indicates that there is a strong negative association between ESG disclosure and ROA which means that high engagement in ESG leads to poor performance in the short-term. One possible factor, the authors suggest, is that efforts to pursue an ESG agenda require additional resources, and those resources are costly relative to the directly profitable business activities that profit-chasing corporations might ultimately shrink. This research is consistent with the stakeholder expense theory (Giannopoulos et al., 2022).

Another research examines the link between ESG performance and financial performance of European publicly listed companies from 2002–2022, focusing on a moderating role of firm's information environment. Established on Refinitiv ESG scores and firm-level financial performance measures, the authors examine a large sample of 707 companies from one well-defined set, the STOXX Europe 600 index, measuring financial performance as the ROA as well as Tobin's Q; return on assets proves consistently and statistically significant, with higher ESG performance relating to profitability. The governance score shows the smallest negative impact among the ESG components, while both environmental and social variables have stronger adverse effects. These results validate the value-destroying view, indicating that ESG investments, despite positive intentioned, lower technological efficiency in the short-term, especially when firms are unable to generate sufficient revenue from their assets (Bahadır & Akarsu, 2024).

The evidence around the financial materiality of ESG factors remains mixed, with a large and growing body of recent literature indicating a consistent null effect between ESG disclosures and fundamental measures of firm performance. The literature across various settings from global equity markets to country-specific contexts has, almost unanimously, failed to uncover statistically significant effects of ESG scores, aggregated or decomposed into specific environmental, social and governance components, on a variety of financial measures, including return on assets (ROA), return on equity (ROE), Tobin's Q or return on investment (ROI). Existing credentials for such a prospective academic, however, did not translate the same way to the public market. These findings call into question the binary narrative that ESG performance necessarily translates into improved returns and highlight a more complicated reality where ESG could be valued in terms of reputational and/or ethical benefit without necessarily being reflected in current or future returns.

Using firm-performance of Malaysian public-listed companies during 2010–2013, this study explored the relationship between ESG factors and firm-performance. Firm performance is assessed based on three key indicators, namely profitability (ROE), firm value (Tobin's Q) and cost of capital (WACC). This study shows that there is no statistically significant relationship between ESG disclosure and profitability (ROE). This means that high ESG score firms did not outperform or underperform low ESG disclosures firms on the basis of accounting-based profitability during the period of analysis. A similar non-significant relationship was found for firm value (Tobin's Q), suggesting that market valuation in this Malaysian setting does not appear to be affected by and/or responsive to ESG activity. The individual ESG dimensions are not significant in the WACC models, but the combined ESG score has a positive and significant effect. More precisely, the data showed that higher ESG disclosure was linked to a higher cost of capital, in contrast to the cause-correlation commonly posited that ESG reduces expected investment risk (Atan et al., 2018).

Another research on the data of 95 NSE-listed Indian companies during the period of 2020 to 2023 that if the ESG disclosure scores can affect the operational (ROA), financial (ROE) and market-based (Tobin's Q) measures of firm performance was carried out by (Shobhwani & Lodha, 2024). Particularly, regarding economic performance (ROE), the effects of both environmental and governance disclosure scores are negative, however, not statistically significant. To be clear we are saying that there is an investment in these under the heading of the environmental or governance look of it, but those investments were in the ordinary course of things, not financially accretive, if not to the negative on the cost to equity returns. In the similar vein, governance disclosure score negatively influences the operational performance (ROA) and it is not significantly contributory. The environmental as well as social dimensions to ROA are positively contributory though not significantly.

In this study, they analyzed if ESG disclosure can affect financial performance of listed firms in nine Post-Soviet states currently within the European Union. The study used a sample of 245 firms and data for the year 2022 extracted from Bloomberg. Financial performance is examined using Return on Assets, Return on Equity and Return on Investment. Multiple linear regression models were adopted, and not only firm age, market capitalization, and R&D expenditure were controlled. Overall, ESG performance does not have a statistically significant effect on all three measures of financial performance (Hansen & Xie, 2025).

In this paper, (Xiao et al., 2013) investigated the relevance of corporate sustainability, as measured by ESG, had a material impact on financial performance at the global level. The authors developed a new measure, a sustainability factor based on sustainability ratings provided by SAM (Sustainability Asset Management), and included it in a Fama–French-style asset pricing model to examine the effect of ESG performance on stock returns. By utilizing data from more than 80 countries and a time period from 2001–2007, the study employed time-series and cross-section regression analyses to investigate the extent to which sustainability relates to a priced risk premium in the global equity markets. The main result is straightforward and robust: The sustainability factor is not a statistically significant predictor of global stock returns, after controlling for the usual market, size (SMB), and value (HML) factors. We conclude no penalty nor premium for investors applying sustainability criteria in their investment decisions, as evidenced by this non-significant relationship. This means that large institutional investors have leeway to engage in ESG strategies without violating fiduciary duties to maximize returns.

The last study compared the relationship between corporate responsibility performance (CRP) and corporate financial performance (CFP), across 599 firms representing 28 countries. Drawing from stakeholder theory, and a resource-based view (RBV) of the firm, the authors argue that the relationship between CSR and financial performance is indirect, mediated by certain intangibles of the firm, such as innovation, human capital, corporate culture, and reputation. Using advanced two-stage econometric techniques to tackle endogeneity and causality issues, the authors discovered that CSR is not directly and positively linked to financial performance. Rather, they provided substantial support that it is their intangible resources that are the key conduits through which CSR can ultimately influence profitability. The study showed that CRP creates a "virtuous circle" where intangibles drive financial performance and the reverse. CSR does not automatically produce superior financial results, unless it translates into realizable internal capabilities (Surroca et al., 2010).

3 DATA AND METHODOLOGY

This section explains the conduction of the empirical part of the study to examine the ESG association to financial performance. First, the section introduces deductive reasoning for guiding the creation of the hypotheses and models. The second part describes the use of LSEG as a database, constructing the sample and its possible limitations and industry classification. Lastly, the chapter justifies the regression models and parts of their different independent and dependent variables among binary variables and how they have been conducted.

The research question is studied by applying 2 hypotheses that are divided into comparing total ESG performance and 6 sub-hypotheses composed of each ESG pillar which are environmental, social and governance. This thesis applies the Tobin's Q and Return on Equity (ROE) to compare different viewpoints to evaluate companies' profitability and value. Hypothesis 1 concludes broad ESG performance's relation to financial performance. Hypothesis 2 includes the firm value into the regression, keeping the overall ESG score. The sub-hypotheses decompose each pillar separately to analyse the impact on the firm performance.

3.1 Research Hypotheses

As discussed in literature review, the findings of the relationship between ESG and financial performance are somehow controversial. However, most of the researchers, especially in recent years, are suggesting that ESG performance has a positive impact on the financial performance of firm. Therefore, the first research hypothesis in this study is as follows:

H1: Does ESG have an impact on the ROA of the companies?

Another measure for financial performance of firm is the market valuation that is commonly measured by Tobin's Q in academic studies. Recent findings suggest that high ESG performance leads to higher market valuation of a company. Therefore, the second research hypothesis is as follows:

H2: Does ESG have an impact on the Tobin's Q of the companies?

The decomposition of each pillar allows to find if a pillar has more importance than another in terms of financial implication. Indeed, Environmental tends to impact firms through resource efficiency, emissions, energy use and often tied to cost savings or regulatory risk. Social covers things like employee welfare, diversity, and community engagement. It might be linked to brand loyalty, productivity, or HR stability. Governance includes board structure, transparency, executive pay and can influence investor trust and long-term stability. By separating these ones, we will be able to see which one(s) drive(s) performance, instead of involving ESG score as a general matter.

H1a): Does Environment pillar have an impact on the ROA of the companies.

H1b): Does Social pillar have an impact on the ROA of the companies.

H1c): Does Governance have an impact on the ROA of the companies.

H2a): Does Environment pillar have an impact on the Tobin's Q of the companies.

H2b): Does Social pillar have an impact on the Tobin's Q of the companies.

H2c): Does Governance pillar have an impact on the Tobin's Q of the companies.

3.2 Sample Data

The study focuses on the European listed-companies from Finland, Germany and France during the period from 2014 to 2018. Companies for which complete data, including all necessary variables, was unavailable were excluded from the sample. The data for this thesis has been retrieved from the LSEG database. To perform a balanced panel data regression, only the companies for which all variables were reported in LSEG in selected period were included in the sample. Some of the largest companies did not have ESG scores for the entire period and as a result, these companies were excluded from this study. After processing the data according to the above description, a total of 680 observations were obtained from Finland, France and Germany.

3.3 Sample Variables

Shobhwani & Lodha (2024) studied the relationship between ESG and financial performance by using different dependent variables. ROA has been used to evaluate the company's operational performance. ROA measures a company's ability to generate profits that can guarantee the firm value. ROA was calculated by comparing net income and total assets :

(1) $$\text{ROA} = \frac{\text{Net Profit}}{\text{Total Assets}}$$

As the accounting-based variables are often influenced by earnings management decisions, market based-items are necessary and are additionally included in many empirical studies. Tobin's Q is the ratio between a physical asset's market value and its replacement value. It has become common practice in the finance and accounting literature to measure the ratio by comparing the market value of the firm's equity and liabilities with its corresponding book values, as the replacement values of a company's assets are hard to evaluate (Velte, 2017).

(2) $$\text{Tobin's Q} = \frac{\text{Market Capitalization}}{\text{Total Assets}}$$

Commonly used control variables in recent studies that investigate the relationship between ESG and financial performance are firm size and leverage. Logarithm of total assets is used as an indicator of firm size, and it is calculated with the following formula:

(3) $$Firm\ Size = \log(Total\ Assets)$$

The second control variable, leverage of the firm, can be calculated by dividing the total debt of the firm by the total assets of the firm. The following formula is used to obtain the leverage variable for this study:

(4) $$Leverage = \frac{Total\ Debt}{Total\ Assets}$$

The last control variable is used to make a decomposition between the countries. This binary variable captures country-level differences between Finland and the other two countries in the sample. It takes the value 1 if the firm is based in Finland, and 0 otherwise. Including this variable allows the model to control for country-specific institutional, regulatory, or cultural factors that may influence the relationship between ESG performance and financial outcomes.

(5) $$\text{Country} \begin{cases} 1\ if\ the\ country\ is\ based\ in\ Finland \\ 0\ if\ the\ country\ is\ based\ in\ France/Germany \end{cases}$$

Some variables were obtained directly from LSEG, while others had to be calculated using Excel. The dependent variables as well as the control variables were not directly available from LSEG, and they had to be calculated separately with the equations presented above. ESG combined score and environmental, social, and governance pillar scores were retrieved directly from LSEG without any additional calculation. Market capitalization and total assets were retrieved from LSEG to calculate the first dependent variable, Tobin's Q. The total of debt was also available in LSEG, enabling the calculation of the leverage variable. The first control variable logarithm of total assets was calculated also in Excel using log function. The second control variable indicating the leverage of a company was calculated by using total debt and total assets that were retrieved from LSEG. All the variables used in this study are summarized in table 5.

Table 5. Summary of variables

Variables	*Description/Formula*
Dependent variables	
ROA – Return On Assets	Net Income/Total Assets
TobinsQ – Tobin's Q	Company Market Cap/Total Assets
Independent variables	
ESGScore	LSEG score
EnvironmentalPillarScore	LSEG score
SocialPillarScore	LSEG score
GovernancePillarScore	LSEG score
Control variables	
Size	Logarithm of Total Assets
Leverage	Total Debt/Total Assets

4 EMPIRICAL RESEARCH

4.1 Descriptive Statistics

The descriptive statistics of each country have been represented in the following tables. In general, an ROA of 5% or less might be considered low, and an ROA over 20%, is high. For an asset-intensive company, an ROA of 5% or even 1% might be acceptable (Investopedia, 2024). For the case of Finland, the mean of the Return On Assets is higher than the 5%. This indicates that, on average, Finnish firms generate approximately 6,4% of profit per euro of assets. The minimum is – 14% and the maximum is 24%, which indicates the presence of the losses and profits for companies. Controversially, there are some similitudes but some differences too for Germany. The ROA is also close to 5%, indicating that German firms on average are profitable. The difference between the maximum and the minimum value is quite large as the minimum is around -11% and the maximum 50%. France showed the lowest ROA in this analysis, showing an average of 3,8%. Surprisingly, the range of minimum and maximum values is narrowed, showing that return on assets is located between -16% and 20%.

The quality of the second variable here is Tobin's Q, defined by TobinsQ. A firm with a Q within the range between 0 and 1 indicates that the replacement cost of the firm ' s assets is more expensive than is reflected in the value of the firm ' s stock. This indicates that the stock is undervalued. Conversely, where Q is high (greater than 1) it indicates a situation in which a firm's stock is "expensive" compared to the cost of replacing its assets over its natural life, which in turn means that the stock is overpriced (Investopedia, 2024b)The average value for the Tobin's Q measure in the Finnish sample equals 1.27, which means that the market value of the firms is higher than the asset book value. But the plot shows a minimum negative value in the range of – 0.19 and a maximum one of 5.62, which clearly diverge from the expected ones. The average Tobin's Q for France and Germany are similar, 0.98 for the first one and 0.83 for the second one. France comes in at the back of the pack (0.83), perhaps indicating negative under-pricing or lower expected growth. But then again, it can be assumed that most of the German and French companies are undervalued since the mean is below 1.

The average score is leading by France, showing an average of 68.52 suggesting higher sustainability standards and more consistent ESG integration. Moreover, France displays the most compact range, with higher minimum scores, implying greater consistency and baseline ESG compliance. Finland and Germany have on average a quite similar ESG score (63.87 vs 64.34) and standard deviation (13.91 vs 13.88). The difference between the two countries is as wide as the span between the minimum and maximum. The wider ESG score range between minimum and maximum in Germany reveals that corporate sustainability performance is rather heterogeneous, which may indicate that ESG integration varies among firms due to sectorial or firm-size differences. With these results, it can already be noted that ESG scores look very similar between the countries, showing that Finland and Germany have a B score and France a B + one (Table 3. ESG scoring ranges and grades). These grades reflect above-average ESG performance for France, suggesting strong integration and reliable disclosure. Germany and Finland are both in the B range, indicating adequate ESG practices but more variation and room for improvement. Concerning each individual pillar, it can be noted that the governance pillar has the lowest value on average. Both social and environmental pillars have quite similar values.

Table 6. Descriptive statistics of Finnish-listed companies.

	Mean	**SD**	**Min**	**Max**
ROA	.064	.059	-.144	.236
TobinsQ	1.275	.992	.194	5.623
ESGScore	63.873	13.912	22.818	91.423
EnvironmentalPillarScore	67.912	19.490	.833	92.857
SocialPillarScore	67.877	15.110	26.117	91.484
GovernancePillarScore	52.968	22.352	12.203	94.762
Size	9.611	.440	8.942	10.652
Leverage	.213	.110	.006	.492
N	*95*			

Table 7. Descriptive statistics of German-listed companies.

	Mean	SD	Min	Max
ROA	.0494	.0545	-.108	.501
TobinsQ	0.977	1.034	.107	6.672
ESGScore	64.334	19.903	7.521	94.938
EnvironmentalPillarScore	64.848	25.103	1.754	98.105
SocialPillarScore	69.436	22.034	2.158	98.202
GovernancePillarScore	57.014	21.692	7.011	96.618
Size	10.237	.769	8.923	12.233
Leverage	.208	.141	.001	.536
N	*260*			

Table 8. Descriptive statistics of French-listed companies.

	Mean	SD	Min	Max
ROA	.0382	.043	-.162	.198
TobinsQ	.831	.962	.0167	6.902
ESGScore	68.523	13.882	32.858	95.735
EnvironmentalPillarScore	74.498	16.583	37.699	97.697
SocialPillarScore	74.384	17.015	27.045	97.995
GovernancePillarScore	55.500	23.161	4.502	93.393
Size	10.300	.684	8.860	12.318
Leverage	.247	.140	.001	.592
N	*325*			

When comparing the control variables, logarithm of total assets indicating the firm size and total debt to total assets indicating the leverage of the company. The analysis showed different results in terms of size. French and German firms look bigger compared to Finnish firms, which are probably smaller and more concentrated in size. In addition, France has the highest average

leverage, suggesting a greater reliance on debt financing. Germany and Finland showed a lowest leverage, indicating lower financial risk exposure.

4.2 Correlation Matrix and VIF

One of the assumptions of the classical linear regression (CLRM) is that there is no exact linear relationship among the regressors. If there are one or more such relationships among the regressors, we call it multicollinearity, or collinearity for short. When there is multicollinearity in the model, it can make it difficult to interpret which variable is affecting the dependant variable (take slide from econometrics course). The Pearson correlation table is computed in this thesis to check the correlation between the variables. This is the most common way of measuring a linear correlation. It is a number between –1 and 1 that measures the strength and direction of the relationship between two variables. If the coefficient is between 0 and 1, there is a positive correlation meaning that when one variable changes, the other variable changes in the same direction. If the coefficient is equal to 0, there is no relationship between the variables. And lastly, if the coefficient is located between 0 and -1, it means that when a variable changes, the other variable changes in the opposite direction (Scribbr, 2024)

The Tables 9,10 and 11 introduce the results of the Pearson correlation conducted on Stata for this thesis. For the three tables, we can notice a significant and positive correlation between ESG score and the E, S and G pillar scores. This was expected as the ESG score is composed of the pillar scores. This high correlation does not affect the study as the ESG variable, and the individual pillar score variables are not used in the same regression model. The strongest correlation is for Germany, which is close to 1. It can also be noted that for all countries, ROA and Tobin's Q have a strong positive correlation, supposing that more profitable firms tend to be more highly valued by the market. Last general element which can be observed is that there is a negative correlation between ESG scores and the dependant variables. Regarding this correlation for Finland, this one doesn't look like to be significant (P-value > 0,05). In other words, firms with higher ESG ratings do not appear to be either more or less profitable than their lower-rated peers, at least in the short term. For the other countries, the negative correlation looks like significant (statistically significant with a P-value > 0,05 for Germany and weakly significant with a P-value > 0,10 for France). Suggests that high ESG scores do not immediately correlate with profitability, possibly due to the long-term nature of ESG investments or higher costs.

Regarding the control variables, size is negatively associated with ROA and Tobin's Q, indicating that size is countered by lower profitability and lower market value. Leverage seems to have a negative effect also on ROA and Tobin's Q, and the result holds as significant for Finnish, German and French companies. The dummy variable "country_esg" (i.e., 1 = Finland, 0 = Germany and France) was implemented so as to account for country level ESG context. Correlation results demonstrate that this dummy is positively and significantly related to ESG scores and to all three ESG pillars, indicating that Finnish firms are embedded in a more developed and integrated environment of ESG. It is also positively related to the firm size variable, i.e. in Finland the firms are on average larger. By contrast, country_esg is not correlated significantly to ROA suggesting that the national ESG environment of a company doesn't necessarily enhance its short-term profits. Additionally, the negative relationship with Tobin's Q, implies that the market may use a more conservative valuation of Finnish firms. Furthermore, inverse correlation with leverage shows that Finnish firms have more conservative financial structures than their European peers.

Table 9. Pearson correlation table of Finnish companies (adapted from Stata)

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
(1) ROA	1.0000								
(2) TobinsQ	0.8270 0.0000	1.000							
(3) ESGScore	-0.1400 0.1761	-0.2011 0.0506	1.000						
(4)EnvironmentalPillarScore	0.0026 0.9800	-0.0481 0.6432	0.8318 0.0000	1.000					
(5) SocialPillarScore	-0.0254 0.8073	-0.0214 0.8370	0.7263 0.0000	0.5124 0.0000	1.000				
(6) GovernancePillarScore	-0.2006 0.0512	-0.2976 0.0034	0.7202 0.0000	0.4084 0.0000	0.2173 0.0344	1.000			
(7) Size	-0.2424 0.0180	-0.3330 0.0010	0.7519 0.0000	0.6630 0.0000	0.3917 0.0001	0.5805 0.0000	1.000		
(8) Leverage	-0.2605 0.0108	-0.2946 0.0038	-0.1409 0.1731	-0.2013 0.0505	-0.2533 0.0132	0.1087 0.2943	-0.1075 0.2999	1.000	
(9) country_esg	-0.1400 0.1761	-0.2011 0.0506	1.000 0.000	0.8318 0.0000	0.7263 0.0000	0.7202 0.0000	0.7519 0.0000	-0.1410 0.0000	1.000

Table 10. Pearson correlation table of German companies (adapted from Stata)

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
(1) ROA	1.0000								
(2) TobinsQ	0.6950 0.0000	1.000							
(3) ESGScore	-0.2336 0.0001	-0.2580 0.0000	1.000						
(4)EnvironmentalPillarScore	-0.3424 0.0000	-0.3739 0.0000	0.8741 0.0000	1.000					
(5) SocialPillarScore	-0.1321 0.0333	-0.1303 0.0357	0.9235 0.0000	0.7657 0.0000	1.000				
(6) GovernancePillarScore	-0.1638 0.0081	-0.2151 0.0005	0.7574 0.0000	0.4788 0.0000	0.5732 0.0000	1.000			
(7) Size	-0.3746 0.0000	-0.4964 0.0000	0.5963 0.0000	0.6795 0.0000	0.4930 0.0000	0.4382 0.0000	1.000		
(8) Leverage	-0.0989 0.1117	-0.2413 0.0001	0.0115 0.8542	-0.1152 0.0637	0.0212 0.7341	0.0367 0.5556	0.0177 0.7758	1.000	

Table 11. Pearson correlation table of French companies (adapted from Stata)

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
(1) ROA	1.000								
(2) TobinsQ	0.7184 0.0000	1.000							
(3) ESGScore	-0.1021 0.0661	-0.2148 0.0001	1.000						
(4)EnvironmentalPillarScore	-0.1994 0.0003	-0.2311 0.0000	0.6746 0.0000	1.000					
(5) SocialPillarScore	0.0908 0.1024	-0.0858 0.1226	0.7338 0.0000	0.4178 0.0000	1.000				
(6) GovernancePillarScore	-0.0992 0.0740	-0.1139 0.0401	0.7044 0.0000	0.2180 0.0001	0.1913 0.0005	1.000			
(7) Size	-0.2129 0.0001	-0.3105 0.0000	0.4283 0.0000	0.4596 0.0000	0.2444 0.0000	0.3206 0.0000	1.000		
(8) Leverage	-0.2289 0.0000	-0.2898 0.0000	0.0096 0.8638	0.1757 0.0015	-0.1127 0.0423	-0.0910 0.1014	-0.1925 0.0005	1.000	

To be more efficient in vehicles studied variables and perhaps effects of multicollinearity, the analysis of amplification variance factor (VIF) was also undertaken for all countries together in the table 12. The VIF is a diagnostic tool to help statisticians in identifying multicollinearity in a model, which occurs when predictor variables are correlated in a multiple regression analysis. It measures the amount that the variance of a regression coefficient is increased given this collinearity. VIF of 1 means that there is no correlation among the independent variables. The larger the VIF, the stronger the correlation among the variables, values commonly being taken as 5 or 10. This paper demonstrates, however, that it is still possible to have large VIFs even in the absence of classical collinearity, especially when the model incorporates dummy variables. Differences in group means, unequal group variances, and small or similar group sizes are all possible ways that VIF can be inflated. Consequently, high VIFs should be greeted only with caution, when the model contains dummy variables, and not used as a rule of thumb on its own to delete predictors, while ignoring the structure and context of the model (Murray et al., 2012) (Murray, 2012)

A VIF is computed as in the figure 7 below :

$$VIF = \frac{1}{1 - r_{23}^2}$$

Figure 7. Variance-Inflating Factor (adapted from the empirical research course)

The VIF was computed for all independent and control variables in the table 12. All VIF values were well below the commonly accepted threshold of 5 (maximum = 1.565; mean = 1.287), indicating the absence of multicollinearity in the regression models. Therefore, the study supposes that the estimated coefficients are unlikely to be distorted by strong correlations among explanatory variables, when considering correlation matrix and VIF analysis.

Table 12. Variance Inflating Factor Analysis

	VIF	1/VIF
Size	1.565	.639
ESGScore	1.442	.694
country_esg	1.126	.888
Leverage	1.016	.984
Mean VIF	1.287	

In order to avoid problems of multicollinearity, a single regression model is run for each ESG pillar. This technique not only minimizes statistical contamination arising from correlation among factors but also enables a clearer distinction of how each ESG dimension independently influences corporate economic performance. Thus, four models with ROA as the dependent variables and four with Tobin's Q dependent variables for each country of the sample were eventually estimated and reported below.

(1) $ROA_{it} = \alpha_0 + \beta_1 ESGScore_{it} + \beta_2 Size_{it} + \beta_3 Leverage_{it} + \beta_4 Country\_ESG_{it}$

(2) $ROA_{it} = \alpha_0 + \beta_1 EnvironmentPillarScore_{it} + \beta_2 Size_{it} + \beta_3 Leverage_{it} + \beta_4 Country\_E_{it}$

(3) $ROA_{it} = \alpha_0 + \beta_1 SocialPillarScore_{it} + \beta_2 Size_{it} + \beta_3 Leverage_{it} + \beta_4 Country\_S_{it}$

(4) $ROA_{it} = \alpha_0 + \beta_1 GovernancePillarScore_{it} + \beta_2 Size_{it} + \beta_3 Leverage_{it} + \beta_4 Country\_G_{it}$

(5) $TobinsQ_{it} = \alpha_0 + \beta_1 ESGScore_t + \beta_2 Size_{it} + \beta_3 Leverage_{it} + \beta_4 Country\_ESG_{it}$

(6) $TobinsQ_{it} = \alpha_0 + \beta_1 EnvironmentPillarScore_t + \beta_2 Size_{it} + \beta_3 Leverage_{it} + \beta_4 Country\_E_{it}$

(7) $TobinsQ_{it} = \alpha_0 + \beta_1 SocialPillarScore_{it} + \beta_2 Size_{it} + \beta_3 Leverage_{it} + \beta_4 Country\_S_{it}$

(8) $TobinsQ_{it} = \alpha_0 + \beta_1 GovernancePillarScore_{it} + \beta_2 Size_{it} + \beta_3 Leverage_{it} + \beta_4 Country\_G_{it}$

where $ROAit$ and $TobinsQit$ are the dependent variables. The independent variables $ESG\text{Score}_{it}$, $E\text{nvironmentPillarScore}_{it}$, $S\text{ocialPillarScore}_{it}$, and $G\text{overnancePillarScore}_{it}$ refer to the ESG combined score, the environmental pillar score, the social pillar score, and the governance pillar score respectively. Control variables, Size_{it} refers to the firm size at the end of the fiscal year, and Leverage_{it} refers to the firm leverage at the end of the fiscal year. The dummy variables Country_ESG_{it}, Country_E_{it} , Country_S_{it} and Country_G_{it} are included to capture country-specific effects related to ESG integration, taking the value of 1 for firms located in Finland and 0 for those based in Germany or France.

4.3 Relationship between ROA and ESG

Figures 8 and 9 introduce the relationship between ESG scores, decomposed of its individual pillars for each dependant variables. The dependant variable is represented on the Y-axis and the independent variable and each for its components are represented on the X-axis.

Figure 8 illustrates the relationship between ESG scores, each individual pillar and the ROA. These scatterplots visually confirm that the relationship between ESG and ROA is generally weak or non-existent in the sample. While the red trendlines show slightly negative or flat slopes across all ESG dimensions, the widespread dispersion of data points around those lines indicates a lack of strong linear association. This supports the correlation matrix results which showed a negative correlation between the dependant and independent variable. Moreover, the points look widely dispersed, especially along the ROA axis. It confirms the fact that no strong linear relationship exists.

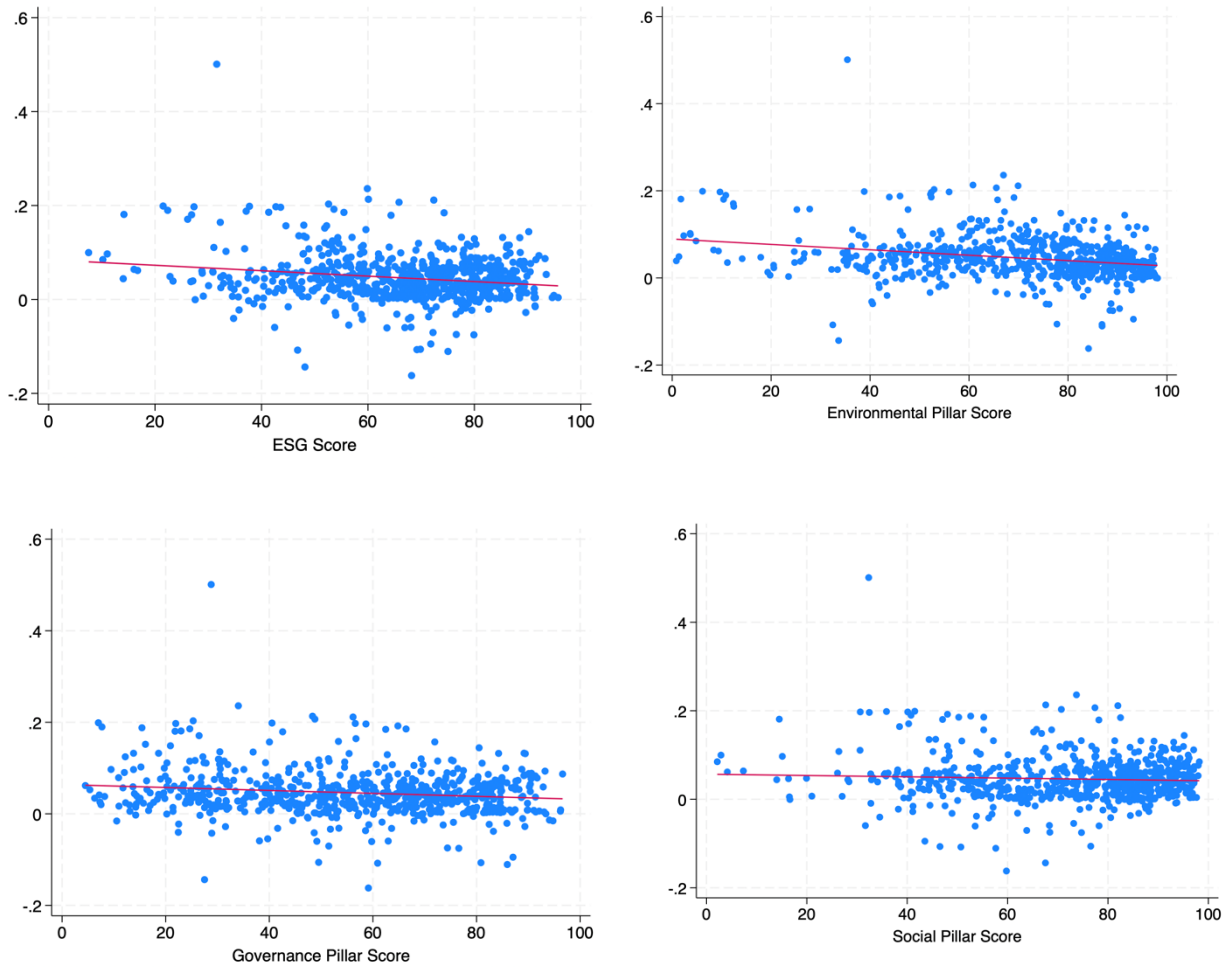

Figure 8. Relationship between ESG and ROA

4.4 Relationship between Tobin's Q and ESG

Figure 9 displays the relation between ESG, decomposed pillars and Tobin's Q. In contrast with the ROA graphs, which present a visible absence of any negative pattern across ESG dimensions. The fitted lines for the Environmental and Governance pillar plots have clear downward trajectories, suggesting that they may have a negative impact on firm value. This agrees with the analysis of correlation matrix carried out in the previous sub-section 4.2.

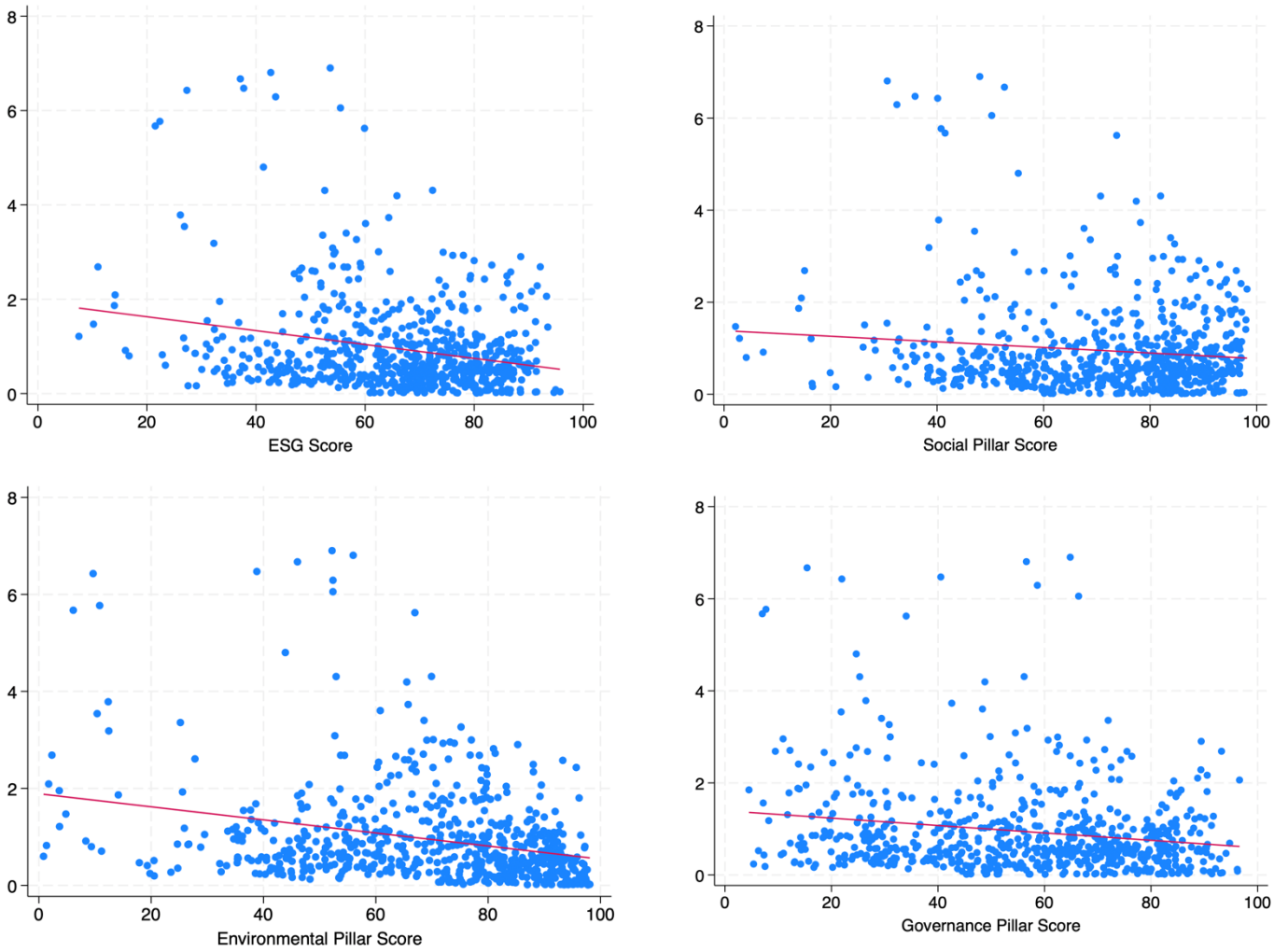

Figure 9. Relationship between ESG and Tobin's Q

4.5 Selection of the Panel Data Model

In panel data estimation, it is essential to choose the appropriate model form to achieve valid estimation and inference. There are three main alternatives namely, Pooled ordinary least squares (Pooled OLS), Fixed effects (FE) and random effects (RE). Analysis is based on firm-level panel data for firms in Finland and Germany in 2014–2018 as well as for firms in France in 2017–2018. The analysis consists of estimated of eight different models (four for Return on Assets (ROA) and four for Tobin's Q), including the full ESG score or one of its three pillars. In order to determine the requirement of panel data structure, Breusch-Pagan Lagrange Multiplier (LM) test is conducted to compare the Pooled OLS model with Random Effects

model. This test checks if the variation between entities is anomaly large to use Random Effects. The 0.05 p-value means the Pooled OLS-model is good enough.

In the event that the Breusch-Pagan test supports the Random Effects model, the Hausman test is performed to compare it with the Fixed Effects model. The Hausman test will test whether the individual effects are correlated with the independent variables. Large p-value (0.05 suggests the preference for Random Effects model.

5 RESULTS

This section presents the results of the regression analysis. The regression analysis intends to answer the research questions. Thus, the regression models intend to describe the relationship between profitability and sustainability. As was explained in chapter 4.2, this study consists of 8 regression models.

5.1 Breusch-Pagan Test for Heteroskedasticity

Prior to choosing the appropriate panel data model, it is crucial to check the homoskedasticity of the regression residuals since it can invalidate statistical inferences. This was addressed after pooled OLS regressions using the Breusch-Pagan/Cook-Weisberg test for heteroskedasticity. The test results reject the null hypothesis of homoskedasticity for the two dependent variables at p-values smaller than 1%. This indicates that the homoskedasticity assumption of the classical linear regression model is violated. To control for this, and to guarantee the proper reliability and interpretations of the coefficient estimates and hypothesis testing, robust standard errors will be employed in all regression models whether following the fixed effects, random effects or pooled approach. This correction is designed to account for heteroskedasticity and so consistent statistics are possible in the empirical analyses that follow.

5.2 Autocorrelation

In order to ensure the robustness of the panel data estimations, it is important to test for autocorrelation, which refers to the correlation of error terms across time within individual firms. Autocorrelation can lead to biased standard errors and misleading statistical inference, especially in panel data models. For both analyses conducted in the tables 13 and 14, no autocorrelation was detected (P-value > 0,05).

Table 13. Autocorrelation considering ROA as a dependent variable

residuals	Coef.	St.Err.	t-value	p-value	[95% Conf	Interval]	Sig
L_residuals	.012	.034	0.34	.734	-.055	.079	
Constant	0	.001	-0.01	.991	-.002	.002	
Mean dependent var		-0.000	SD dependent var			0.022	
R-squared		0.000	Number of obs			544	
F-test		0.116	Prob > F			0.734	
Akaike crit. (AIC)		-2594.044	Bayesian crit. (BIC)			-2585.446	

Table 14. Autocorrelation considering Tobin's Q as a dependent variable

residuals	Coef.	St.Err.	t-value	p-value	[95% Conf	Interval]	Sig
L_residuals	.082	.044	1.88	.06	-.004	.168	*
Constant	.019	.009	2.08	.038	.001	.037	**
Mean dependent var		0.021	SD dependent var			0.214	
R-squared		0.006	Number of obs			544	
F-test		3.542	Prob > F			0.060	
Akaike crit. (AIC)		-132.444	Bayesian crit. (BIC)			-123.846	

5.3 Breusch-Pagan LM Test

The conventional wisdom starts off seeking to ascertain if simple pooled OLS is appropriate, or whether within a panel model is thus justified. The Breusch-Pagan LM test tests for significant variations between firms. The null hypotheses is whether there are no panel effects (i.e. the error component is zero), meaning that a pooled OLS is sufficient. The null hypothesis is that there is no variance at the firm level, and pooling is appropriate, while the alternative is that there is some firm-level variance, and a Random Effects model is preferred. The test was performed twice. One using ROA as dependent variable and the other applying Tobins'Q. For both tests, the P-value was below the 0.05 standard indicating that the null hypothesis of no panel data is rejected. This demonstrates that there exists unobserved heterogeneity among firms and a panel provide a better fit than a pooled model.

5.4 Hausman Test

As the Breusch-Pagan LM test indicated the need of panel model, the next step is to choose whether it is better to use fixed effects or random effects. This question is addressed by

performing the Hausman test. A significant Hausman test ($p < 0.05$) means we reject the null hypothesis, indicating that the safer model is Fixed Effects (since RE assumptions appear violated). On the other hand, a null effect ($p \geq 0.05$) indicates no evidence of correlation, so that a more efficient Random Effects is suitable. The p-value of the Hausman's tests for both models was above 0.05 (0.0917 and 0.4868, respectively). These findings imply that the null hypothesis, that both Random-Effects models and are appropriate specifications for the two cases, cannot be rejected. The analysis will therefore continue as random effects and robust standard errors.

5.5 Regression Analysis

8 regression models have been run on Stata, taking in consideration each dependant variable and decomposition of each pillar of ESG. The summary tables show the results of the selected regression analysis between the independent separate ESG variables, control variables firm size and leverage, and the dependent variable Return on Assets or Tobin's Q. Variables are retrieved from LSEG database.

Significance levels are denoted in the tables through asterisks positioned beside the coefficients. The absence of an asterisk indicates that the coefficient is not statistically significant. Three asterisks indicate statistical significance at the 0.01 level, two asterisks denote significance at the 0.05 level, and one asterisk implies significance at the 0.10 level. Additionally, the adjusted R-squared value is provided in the table, offering insights into how effectively the model explains the variance of the dependent variable. Moreover, the adjusted R-squared value is provided in the table, offering more insights into how effectively the model explains the variance of the dependent variable.

The table 15 shows the results of the first regression analysis conducted using both ROA and Tobin's Q as dependent variables. This regression analysis shows that neither ESG performance nor the country-specific ESG variable has a statistically significant effect on firm profitability (ROA). However, both firm size and leverage exhibit significant negative relationships with ROA, indicating that larger and more highly leveraged firms tend to be less profitable. The model as a whole is statistically significant ($\chi^2 = 25.60$, $p < 0.01$) with an R^2 of 0.141, indicating that the model accounts for approximately 14% variability in the ROA. The

findings indicate that ESG operations do not directly influence short-term profits, meanwhile the size of a firm and its capital structure still contribute strongly to the firm's performance.

Table 15. Regression results

Independent Variables	Dependent Variables	
	(1) ROA$_t$	**(2) TOBIN'S Q$_t$**
ESGSCORE$_t$	0.000 (0.844)	-0.002 (0.435)
ENVIRONMENTALPILLARSCORE$_t$		
SOCIALPILLARSCORE$_t$		
GOVERNANCEPILLARSCORE$_t$		
LEVERAGE$_t$	-0.054*** (0.008)	-1.13*** (0.000)
COUNTRY_ESG$_t$	0.000 (0.699)	-0.001 (0.809)
SIZE$_t$	-0.022*** (0.000)	-0.63*** (0.000)
CONSTANT	0.283*** (0.000)	7.737*** (0.000)
OBSERVATIONS	680	680
R-SQUARED	0.141	0.239

Note: The independent variables are ESGSCORE$_t$ = current year ESG combined score, ENVIRONMENTALPILLARSCORE$_t$=current year environmental score, SOCIALPILLARSCORE$_t$=current year social score, GOVERNANCEPILLARSCORE$_t$= current year governance score, LEVERAGE$_t$= current year financial leverage and SIZE$_t$= current year natural logarithm of total assets. The dependent variables are ROA= current year return on asset and TOBIN'S Q= current year market valuation. P-values in parentheses: * p <0.1, ** p <0.05, *** p<0.01. Data source: LSEG.

The regression conducted in the table 15 including the Tobin's q shows some similar patterns with the ROA. ESG performance remains statistically insignificant (p = 0.435), suggesting that

ESG scores do not have a significant influence on firm valuation in the sample. Nevertheless, both firm size and leverage still show strong negative associations with our measure of firm value (Tobin's Q), suggesting, again, that larger and more leveraged firms are less valuable in the eyes of the market. The model explains slightly less than a quarter of the variation in firm valuation. Like the profitability model, the country dummy variable is insignificant which supports our claim that cross-country ESG-related context might not be a direct factor affecting firm value in our sample.

By identifying the pillars individually, several differences can be noticed. Still considering ROA as the dependent variable, it can be noticed in the table 16 that the social pillar score is considered more positive compared to the models studied previously. However, this pillar is not statistically significant but weakly significant (P-value < 0,10). It suggests that better social ESG performance may have a weakly positive effect on profitability, but not strong enough to be conclusive at the 5% level. Using the Tobin's Q as dependent variable, the results show that the governance pillar has a significant negative effect on the firm value. It suggests that higher governance scores are associated with slightly lower firm valuation. The model can't give a theoretical answer, but it can be implicitly explained by the fact that stricter governance limit short-term profits, signal caution to investors, or governance quality being higher in firms facing internal challenges. Moreover, it can be related to the agency theory to introduce the fact that companies implement mechanisms to align manager's interests with shareholders ones.

Table 16. Regression results of separated pillars

Independent Variables	Dependent Variables	
	(1) ROA_t	(2) TOBIN'S Q_t
$ENVIRONMENTALPILLARSCORE_t$		
$SOCIALPILLARSCORE_t$	0.000* (0.076)	
$GOVERNANCEPILLARSCORE_t$		-0.003** (0.046)
$LEVERAGE_t$	-0.052*** (0.009)	-1.141*** (0.000)
$SIZE_t$	-0.025*** (0.000)	-0.612*** (0.000)
$COUNTRY\_ESG_t$	0.000 (0.701)	-0.001 (0.708)
CONSTANT	0.292*** (0.000)	7.601*** (0.000)
OBSERVATIONS	680	680
R-SQUARED	0.1414	0.2390

Note: The independent variables are $ESGSCORE_t$ = current year ESG combined score, $ENVIRONMENTALPILLARSCORE_t$=current year environmental score, $SOCIALPILLARSCORE_t$=current year social score, $GOVERNANCEPILLARSCORE_t$= current year governance score, $LEVERAGE_t$= current year financial leverage and $SIZE_t$= current year natural logarithm of total assets. The dependent variables are ROA= current year return on asset and TOBIN'S Q= current year market valuation. P-values in parentheses: * p <0.1, ** p <0.05, *** p<0.01. Data source: LSEG.

6 CONCLUSION

In an unsustainably interconnected world, ESG have become the yardsticks by which the full range of decisions from personal to governmental, are relatively responsible. With ESG, we will assess the organizations, not just their financial performance, but how they impact the planet, society and how they govern themselves. So, incorporating ESG factors is not only about long-term risk management or ethical accountability, but also a driver of innovation, in turn building stakeholder trust and creating a global impetus for sustainable development. So ESG has become a critical lens through which public and private institutions can work through complex challenges and pursue meaningful, sustainable growth.

6.1 Key Findings

This thesis has thematized how European firms' financial performance have been affected by the integration of ESG criteria, considering only Finnish, German and French firms. The aim of studying this influence is to verify if the results were the same as prior theories showed, which determined there was a positive and important relationship among both variables. Regression analysis was employed to investigate research questions and cluster all the variables used together.

Regarding sustainability and profitability, the results of the linear regressions, using the overall ESG scores as independent variables and Return on Assets and Tobin's Q as dependent variables, demonstrated that these results are no direct link between these two categories. In the case of the ROA, the regression coefficient linking the ESG with the two dependent variables equals to 0 and negative but close to 0 in the case of the Tobin's Q. We do not find any statistical significance in measurements of these two linear regression models with the P-value of (0,05) clearly above threshold. Due to these findings, the first hypothesis is to be rejected, meaning that there is no significant positive or negative relationship between sustainability and profitability.

The results of the linear regressions for each individual pillar with the dependent variables presented similar findings overall but some differences were observed. Subsequent analysis results indicated that the social pillar score was perceived as significantly more positive

relative to the previously examined models. However, this pillar is only weakly significant (P-value < 0,10). It indicates that poor social ESG performance should not strongly be associated with a good ROA or this an effect of the better financing to gain resources to a higher ROA if compared to lower performing companies, but there is little evidence for the correlation at the 5% level. Also, the governance pillar contributes negatively the firm value. It implies that higher governance scores also result in slightly lower firm valuation.

Conversely, size and leverage, the control variables presented in this thesis, had a negative and significant effect on the financial performance of the firms. It indicates that big firms and firms with high leverage are worse on the outcomes examined. Another interpretation could be that larger firms are subject to higher scrutiny or have more complex operations, making them more sensitive to ESG or reducing their financial flexibility. In the same vein, financially weak firms with high levels of debt might face resource constraints or become risk-averse, restricting their capacity to invest in sustainable or socially responsible initiatives. It indicates that one of these two ones might need receiving consideration.

6.2 Link between the Analysis and Theories

CSR has several theories which share different perspectives relating to the relationship between ESG practices and financial performance. According to theories including the resource-based view and natural resource-based-view, ESG can be a basis for sustainable competitive advantage as firms can use their tangible and intangible resources effectively to achieve better, long-term financial results. Likewise, the institutional theory and legitimacy theory propose that firms must adopt ESG practices to conform to societal norms to ensure legitimacy and retain their license to operate, which indirectly could protect their financial stability and reputation through performance . The stakeholder theory also validates the positive correlation between ESG and financial performance, arguing that catering to multiple stakeholders through ESG practices, increases the company reputation in the market and also stakeholder loyalty, which leads them to earn superior long-term profits. Similarly, frameworks such as the triple bottom line promote a balance between profit, people, and profit, and urge the companies to go after social and environmental objectives as part of a sustainable business model that accompany financial success.

On the other hand, more skeptical views of ESG, such as the shareholder theory and certain strands of the agency theory perspective, see ESG as potentially distracting companies from their most important goal, which they argue is maximizing shareholder value. These theories can be appalling, warning that ESG programs that do not tangibly improve profits will be perceived as misdirections of corporate progress, or worse, as vehicles for "greenwashing". The trade-off theory, on the other hand, allows for a nuanced conception of the link between ESG performance and financial performance, because it identifies that ESG investments may, at least on a short-term basis, increase the costs of an organization, which may be reflected in certain financial metrics (e.g. ROA or Tobin's Q).

The regression models in this study did not show a striking relationship between ESG scores and the financial performance. The results don't really find support for the theories that there is a positive relationship between these variables. This is doing in a way to separate each of the pillar, and it can show a weak link between social pillar and return on assets. Also, the relationship between the governance and the firm value was negatively and significantly correlated as well. These results reinforce the debate aligned with the Trade-off Theory: some ESG aspects can provide long-term advantages, but their influence on financial performance is inconsistent and may be dependent on stakeholder perception, strategic implementation, and market expectations.

6.3 Future Perspective

The defense space was already facing sidelining by institutional investors due to increasing ESG standards before war broke out in Ukraine. The performance seemed more than commendable, and despite rock-solid profitability, many investors opted to divest, largely because of prevailing public opinion and ethical concerns related to the nature of defense.

But the geopolitical landscape was drastically altered with the conflict in Ukraine when it erupted in February 2022. Perception of public opinion shifted, and likewise it was institutional investors who began to re-enter the defense sector. In that year, institutional investors of all stripes increased their holdings in the 16 largest defense companies by 6% (PwC), signifying an adjustment in the perception of the sector's strategic and social value.

Given Europe's rising defense budgets and persistent security threats, defense companies are under pressure to navigate the space between national security needs and ESG pressures. Three potential strategic paths are emerging that could help these companies find their way toward ESG alignment according to PwC. At a fundamental level, companies can "overachieve," strengthening broader ESG practices like increasing transparency or using renewable energy. A more progressive path means "adapting" defense by transforming related practices to better "meet ethical standards, ensure supply chain responsibility and communicate." The most radical is the "rethink" part, that asks companies to completely rethink what they do, prioritizing dual-use or non-lethal technologies while avoiding products associated with conflict or civilian harm.

Forward thinking firms that adopt the higher echelons of this ESG strategic pyramid, especially those creating innovation, transparency and ethical leadership, will likely find themselves in quicker alignment with those forthcoming regulations sprinkled across legislation such as the European Union Taxonomy and the Corporate Sustainability Reporting Directive (CSRD). Beyond compliance, such endeavours may boost investor confidence and fortify long-term financial performance. As the meaning of "responsible investment" continues to change, defense players' capacity to authentically integrate ESG principles into their operations may soon be a deciding factor in both the financial markets and the larger social landscape (PwC)

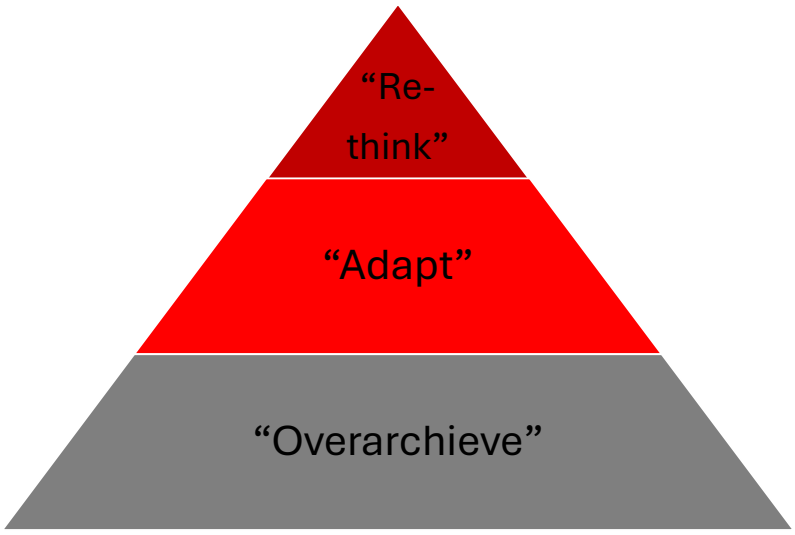

Figure 10. Strategy to employ (adapted from PwC)

6.4 Suggestions for Future Research

The purpose of this thesis was to investigate the link between ESG performance and financial performance in the context of three European countries: Finland, Germany and France. In general, it is indicated in the results that ESG scores are not materially related to the firm profitably and the market value for the analysed firms. However, if ESG is broken down into its three constituent components, we find that social factors and governance matter more for financial performance than environmental matters.

In these directions some possibilities for future work can be considered to extend the analysis. First, it might be worth considering alternative data sources such as Bloomberg Terminal, MSCI ESG Ratings or Sustainalytics for a different angle (ESG and financial metrics can differ substantially between providers because of different methodologies, coverage and scoring). It would increase the reliability and generalizability of the results if the robustness of the findings could be tested with more databases.

Moreover, altering the dependent variable choice, that is, instead of Return On Assets or Tobin's Q to select other ratio such as profit margin, stock price, and market-to-book ratio may provide additional clarification regarding the impact of ESG factors on different dimensions of financial performance. Likewise, the robustness of the study could be increased by testing an alternative set of control variables. Although leverage and firm size are the variables under consideration in this study, other factors (industry sector, R&D intensity, market concentration, ownership structure, etc.) could also potentially affect the relationship between ESG performance and financial performance.

Another potential avenue of research would be focusing the analysis to the industry level, such as industries that feature energy, technology and finance in which ESG matters are more relevant and the effect can be quite stronger. Industry-detail studies may also help uncover effects that are harder to identify in more general market investigations, and this could be especially true given distinct regulatory pressure and stakeholder expectations across industries.

Another interesting research path would be to change the observation time. For example, if we also had data for the period of the COVID-19 pandemic, we could potentially see whether the ESG factor played an even greater role during crisis times. Anticipating the future, as the impact of the Ukraine-Russia war and the subsequent increased expenditure on defense unravels, it will be especially intriguing to observe whether such geopolitical developments lead to an observable development of the ESG-financial performance relation.

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8 APPENDIX

During the progress of this thesis, ChatGPT created by OpenAI, was referenced. It helped the writer to rewrite sentences in a clear, coherent manner, find grammatical errors and to find related academic readings for reference. ChatGPT was particularly useful for the methodology part, even in proofreading and improving the formulation of regression analysis, descriptive statistics, and interpretation of scatter plots. On several occasions, it also gave him new ideas of other topics and perspectives that he could incorporate in the thesis. Additionally, it was a cross-reference to ensure the results would be recognized as consistent in light with previous research. All outputs produced by ChatGPT were systematically reviewed for correctness, appropriateness, and quality according to academic norms and were integrated into the final work.