

ERASMUS UNIVERSITY ROTTERDAM

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# **ESG performance and shareholder returns**

An analysis of the relationship between ESG performance and  
the returns for shareholders

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The views stated in this thesis are those of the author and not necessarily those of the supervisor,  
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# Abstract

This study focuses on the relationship between Environmental, Social, and Governance (ESG) performance and shareholder returns. As shareholder returns consist of dividends and the increase in market value, both elements in relation to ESG performance are considered. The purpose of the research is to conclude whether ESG performance increases or decreases shareholder value. Furthermore, the study differentiates between firms operating in emerging and developed countries, as prior research showed differences between the two. Using data from the Refinitiv Eikon database, for the period 2017-2022, a regression analysis is performed. The results show no significant relationship between ESG performance and dividend payout. This is in contrast to a negative relationship that is found between ESG performance and market value, although the economic value of this relationship is very low. When differentiating between emerging and developed countries, the negative relationship between ESG performance and market value is only present for firms operating in developed countries, in contrast to the expectations from the literature.

Keywords: ESG, dividend payout, market value, emerging countries

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# Chapter 1: Introduction

The interest in achieving sustainability goals has been increasing over the last decades. Examples of this growing interest are the Paris Agreement of 2015 and the Sustainable Development Goals developed by the United Nations. These two examples are political initiatives, but also businesses can contribute to a more sustainable world. The actions that companies take to increase social welfare through their business are often referred to as Corporate Social Responsibility (CSR) or ESG (Gillan et al., 2021). Although there are some differences between ESG and CSR, the terms are often used interchangeably according to Chen et al. (2017), so for consistency, ESG will be used throughout this research.

Reporting on ESG has been emerging over the last years (Tschopp & Huefner, 2015). The Corporate Sustainability Reporting Directive (CSRD) will increase the number of firms that need to report on ESG in the EU, but most of the information reported until 2025 is voluntary. Still, 95% of the large companies in the world reported on ESG matters in 2021 (IFAC, 2023). This means that there is a lot of information available about the ESG performance of companies, but it might be difficult to interpret the quality and reliability of this information. To be able to better interpret the ESG disclosure, multiple institutions are measuring the information through ESG indicators. These indicators can be used to measure the amount of effort firms put into their ESG activities.

Companies might not be interested in engaging with ESG, as they might believe that this is disadvantageous for their shareholders. According to neoclassical theory, companies should then not engage in these activities, as according to Friedman (1970): “there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception fraud.” This implies that the company should maximize the value for shareholders. On the other hand, authors such as Freeman (2004) argue that the company should create value for all stakeholders. However, if ESG activities also increase shareholder value, this will mean that according to both views, firms should engage with ESG.

## 1.1 Research question

It is described by Reynolds (2014) that the possible returns that shareholders get consist of dividend payments and capital growth, reflected by an increase in market value. The same definition will be used throughout this thesis. Therefore, shareholder returns will refer to the combination of dividend payouts and capital growth, in the form of an increase in market value. To investigate whether better ESG performance is associated with higher shareholder returns, the following research question is formulated:

*What is the relationship between ESG performance and the returns of shareholders?*

As shareholder returns consist of dividends and capital growth, both aspects need to be considered when examining the relationship between ESG performance and shareholder returns. For dividends, the dividend payout will be looked at, while the market value will be investigated when researching the capital growth. Moreover, ESG performance needs to be measured. This will be done by looking at ESG indicators, which transparently and objectively measure a company's relative ESG performance.

## **1.2 Social and scientific relevance**

This research is socially relevant as it can contribute to the sustainability debate. Politics increase their willingness to contribute to a sustainable world. Moreover, also businesses need to start increasing their ESG activities since reporting on this becomes mandatory from 2025 onwards as a result of the CSRD. As this research tries to capture the relationship between the ESG performance of firms and their returns to shareholders, it contributes to the debate about ESG. If a positive relationship is found, this can lead to the conclusion that firms need to increase their ESG activities. However, if a negative relationship is found, this might lead to the conclusion that ESG is disadvantageous for shareholders so that people who can be considered neoclassical will be against an increase in ESG activities.

Moreover, the research is scientifically relevant, as more research into this topic is needed. ESG has been investigated intensively over the last few years, but there is still a lack of research, specifically into the shareholder returns as a result of ESG performance. Friede et al. (2015) did a literature review and found that the large majority of studies on the relationship between ESG performance and financial performance show a positive relationship. Moreover, Niccolo et al. (2020) show that investments in ESG negatively influence dividend payouts, while Ellili (2022) shows a positive relationship between ESG disclosure and dividend payouts. This means that research focuses on either dividend payout or market value, while this research tries to capture total shareholder return. In that sense, it will contribute to the existing literature, and add a new viewpoint to it. Moreover, this research will also differentiate between emerging and developed countries, which also contributes to the literature.

## **1.3 Thesis outline**

This research exists of 5 chapters. In the next chapter, the theoretical framework will be presented. In this part, different scientific books and articles will be used to lay a theoretical foundation, which ultimately results in the hypotheses for this study. Thereafter, Chapter 3 will describe the data and methodology of this research. In Chapter 4, the methodology is executed. This means that the empirical results will be presented there, whereafter it is possible to conclude whether the null hypotheses can be rejected. Finally, this research is concluded in Chapter 5. The central research question will be answered and discussed here. After that, the limitations will be mentioned, and some recommendations for further research will be given.

## Chapter 2: Theoretical framework

In this chapter, the theoretical framework that is needed for the rest of the paper will be presented. Scientific articles and books will be used to show the research that is already done, and the gap in the literature that this research will try to fill. In 2.1, the concepts that are important for this research will be defined, which are ESG, shareholder returns, and the shareholder and stakeholder theory. 2.2 will then continue with the relationship between ESG and dividends. In 2.3, a similar relationship will be discussed, but then between ESG and market value. Lastly, 2.4 will conclude this chapter with the hypotheses resulting from the theory.

### 2.1 Defining important concepts

ESG and CSR have been growing rapidly in importance over the last few years but the terms are not new. Already in the 1970s, CSR was described as something that corporate strategists had to deal with (Bowman & Haire, 1975). Gillan et al. (2021) describe that CSR traditionally refers to the activities of companies regarding being more socially responsible. These authors describe ESG on the other hand as the integration of environmental, social, and governance into the business models of firms. The difference between them is that ESG includes governance explicitly, while CSR includes it indirectly so ESG can be seen as a somewhat more expansive term than CSR (Gillan et al., 2021). However, according to Chen et al. (2017), ESG and CSR can be used interchangeably, as the differences between the terms are negligible. This is also done by Gillan et al. (2021) in their research, so ESG will be used throughout this research for consistency.

Next to a definition of ESG, it is also necessary to define shareholder returns. It is already described in the introduction that the definition of Reynolds (2014) will be used. This means that the returns of shareholders are a combination of the payments of dividends and capital growth in the form of market value. The payment of dividends arises when a firm makes profits, where all or part of these profits are redistributed to the shareholders (Al-Malkawi et al., 2010). Miller and Modigliani (1961) have argued that in a perfect market, dividend policy is irrelevant to the wealth of shareholders. However, since markets are not perfect, a lot of companies still pay dividends, for example to signal to shareholders that the firm is doing well (Al-Malkawi et al., 2010). Next to dividends, the second part of shareholder returns is capital growth. This is defined as an increase in market value, which is why the market value will be looked at when discussing capital growth.

Bowman and Haire (1975) found a positive relationship between corporate social responsibility activities and profits already in the 1970s. However, they argue that this relationship is not causal, but that there is a different factor behind it that causes both factors to increase. Information about ESG is scarce since most of this information is non-mandatory (Christensen et al., 2021). However, according

to Amel-Zadeh and Serafeim (2018), the demand for information about ESG has risen. As there are mandatory disclosures for large firms in the near future, it is interesting to see what effect this has. Prior research shows that firms positively change their behavior if ESG disclosure becomes mandatory (Christensen et al., 2021). An example of this behavior is found by Mbanyele et al. (2022), as firms increase their green innovation output and quality in countries that adopted ESG disclosure laws compared to their counterparts. A similar effect is found by Hao and He (2022), who concluded that ESG performance has a significant positive impact on green innovation. Jackson et al. (2020) also looked at the relationship between mandatory disclosure laws and CSR. Although these authors looked at the broader topic of Non-Financial Disclosure, they still found a positive effect of disclosure on ESG activities. However, when looking at the relationship between mandatory ESG disclosure and firm profitability, a negative relationship is found by Chen et al. (2017).

Since ESG disclosure is mostly voluntary until 2025, multiple agencies are rating the ESG performance of firms. Berg et al. (2022) have compared six prominent ESG rating agencies: Kinder, Lydenberg, and Domini (KLD); Sustainalytics; Moody's ESG (Vigeo-Eiris); S&P Global (RobecoSAM); Refinitiv (Asset4); and MSCI. These authors found that these agencies substantially disagree about the ESG ratings since the correlation between ESG ratings ranges from 0.38 to 0.71. The authors conclude that researchers should be careful when using ESG ratings, especially with the ratings from KLD since there is a lot of divergence in that data. However, the ESG ratings are necessary to compare the ESG activities of firms.

The effect that ESG activities have on the general financial performance of firms has been studied extensively. Already at the end of the last century, Waddock and Graves (1997) found a positive relationship between ESG ratings and prior financial performance, as well as between ESG ratings and subsequent financial performance. When replicating this research with more data and across a longer timeframe, Zhao and Murrell (2016) found the same relationship between ESG ratings and prior financial performance, but these authors doubt whether the positive relation between ESG and subsequent financial performance still exists. Mallin et al. (2014) showed that ESG disclosure and financial performance are also positively associated, but concluded that better financial performance causes more ESG disclosure. More recently, Awaysheh et al. (2020) found a positive relationship between ESG and financial performance but questioned whether this effect is causal at all. When looking at emerging markets in Latin America, a significantly negative relation between ESG score and financial performance is even found (Duque-Grisales & Aguilera-Caracuel, 2021). This can however be due to the fact that differences exist between emerging countries and developed countries. Evidence for this difference between emerging countries and developed countries in the relationship between ESG and financial performance is found by Garcia and Orsato (2020). The foregoing can lead to the conclusion that there is no consensus in the literature on whether ESG is positively or negatively related to financial performance.

Since it is not clear whether ESG activities positively affect the financial performance of a firm, questions may arise about whether firms should adopt those activities at all. There are two views on this: the neoclassical shareholder theory and the stakeholder theory. The neoclassical theory is developed by Friedman (1970). He argued that firms should only focus on maximizing profits, as this creates value for its shareholders, which according to him is the only obligation that a company has. As a result, the neoclassical view on ESG is that firms should only undertake these activities if it is beneficial for the shareholder's value. In contrast to this, there is the stakeholder theory. This theory is developed by Freeman in 1984 and revisited in 2004 (Freeman, 2004). The idea of the stakeholder theory is that a firm should not only focus on creating value for its shareholders but that it should take into account all stakeholders, which include employees, customers, communities, et cetera. This means that firms should always undertake ESG activities, as these activities create value for stakeholders, but not necessarily for the shareholders. This view is also supported in recent literature. For example, Schaltegger et al. (2019) have argued that identifying the needs of all stakeholders will help businesses with creating sustainable value.

## **2.2 Relationship ESG and dividends**

Cheung et al. (2018) discussed two channels through which ESG activities can affect dividend policy. On the one hand, there is the earnings channel. This view states that ESG performance increases earnings, which in turn increases dividends. On the other hand, Cheung et al. (2018) discussed the equity cost of capital channel. The idea behind this channel is that ESG performance lowers the cost of capital, which will incentivize the firm to hold cash or invest instead of paying dividends. If the earnings channel dominates, ESG performance positively affects dividends, while ESG performance will negatively affect dividend policy if the equity cost of capital channel dominates. The data suggest that the earnings channel dominates, so that ESG performance is positively associated with dividend payouts (Cheung et al., 2018).

The same relationship is found in different countries and continents: Samet and Jarboui (2017) in European companies, Benlemlih (2019) in US firms, Badru and Qasem (2021) in Malaysian businesses, Salah and Amar (2022) in French firms, Dahiya et al. (2023) in Indian companies, Dewasiri and Abeysekera (2020) in Sri Lankan firms, and Fonseka and Richardson (2023) in Chinese businesses. Sheikh (2020) also found a positive relationship between ESG performance and dividend payouts but concluded that this relationship is only present in low-competition markets. A positive association is also found when looking at the relationship between dividends and ESG investments (Rakotomavo, 2012), between dividends and ESG expenses (Trihermanto & Nainggolan, 2018), between dividends and ESG transparency, and between dividends and mandatory ESG disclosure (Fonseka & Richardson,



2023). Finally, ESG performance can also be related to dividend stability. Both Matos et al. (2020) and Benlemlih (2019) show that better ESG performance is associated with a more stable dividend policy.

The aforementioned shows that most studies seem to indicate that ESG is associated with higher dividend payouts and more stable dividend policies. However, there are also a few studies that argue the opposite. Niccolo et al. (2020) show that investments in ESG negatively influence dividend payouts. This is thus contrary to Rakotomavo (2012), as a positive association between ESG investments and dividends is shown there. However, Niccolo et al. (2020) emphasize that the result should not be interpreted in the sense that shareholder value is decreased, as the market value or dividends might increase in the future. Another research that shows a negative relationship between ESG and dividends is conducted by Saeed and Zamir (2021). These authors show that ESG disclosures exert a negative impact on corporate dividend payment, in emerging markets. Ni and Zhang (2019) also show that ESG disclosure is negatively associated with dividends, although they specifically looked at mandatory ESG disclosure. The negative association between ESG disclosure and dividends found by Saeed and Zamir (2021) and Ni and Zhang (2019) is in contrast with the findings of Fonseka and Richardson (2023), as these authors found a positive relationship. There are thus some articles in the literature that have found a negative relationship between ESG and dividends. However, most of the articles show that ESG is positively associated with dividends.

## **2.3 Relationship ESG and market value**

It is argued by Christensen et al. (2021) that studies that try to capture the relationship between ESG and market value show mixed results. This would be in contrast to the articles about ESG and dividends which mainly showed a positive association. Theoretically speaking, it is expected that greater ESG performance increases a firm's value (Gillan et al., 2021). This positive association between ESG and firm value is also found in the data. Chang et al. (2022) show that ESG practices increase firm value by motivating employees, strengthening customer-supplier relationships, boosting long-term growth, increasing dividends, and reducing financing costs. The same relationship between ESG performance and market value is found by Zhou et al. (2022). Moreover, Li et al. (2017) found a positive association between ESG disclosure and firm value, where they reported that higher CEO power enhances this relationship. Xie et al. (2019) did not necessarily find this positive relationship but did find that most of the ESG activities are nonnegatively related to market value.

Next to the positive relationships that are found in the literature, some authors do not find such a clear association between ESG and firm value. Aouadi and Marsat (2018) surprisingly show that ESG controversies are associated with greater firm value. Buchanan et al. (2018) do find a positive relationship between ESG and firm value before the 2008 global financial crisis but show that ESG is negatively associated with firm value during this crisis. Moreover, Del Mar Miralles-Quirós et al. (2019)

found that the relationship between the social performance of banks and firm value is negative, although this relationship is positive for the environmental and governance practices. These authors also emphasize the difference between emerging countries and developed countries, for the relationship between ESG and firm value. There are thus some mixed results for the relationship between ESG and firm value but the literature review by Friede et al. (2015) shows that most studies found a positive relationship. Moreover, it is also shown that in roughly 90% of the studies, a nonnegative relationship is found (Friede et al., 2015). It is expected that the negative relationship is only present in the short-term, or is the result of mandatory ESG laws (Christensen et al., 2021).

## 2.4 Hypotheses

The literature review has led to the formulation of eight hypotheses related to the central research question. Those eight hypotheses consist of four times a null hypothesis and an alternative hypothesis, where for each combination of hypotheses the ‘a’ part is the null hypothesis and the ‘b’ part is the alternative hypothesis. The first null hypothesis and alternative hypothesis are related to the literature about ESG and dividends. Although some articles show a negative relationship, most of the research found that ESG is positively associated with dividends. According to Cheung et al. (2018), this means that the earnings channel dominates, which means that ESG performance increases earnings, which causes dividends to increase as well. Therefore, the same relationship is expected in this research, which leads to the first null hypothesis and alternative hypothesis:

*Hypothesis 1a: ESG performance is not positively associated with dividend payout.*

*Hypothesis 1b: ESG performance is positively associated with dividend payout.*

The second null hypothesis and alternative hypothesis are related to the first hypotheses but will dive into a specific part of the relationship between ESG performance and dividend payout. As some articles are pointing out a difference between emerging countries and developed countries, the second hypotheses will be about this difference. There is a lack of research into the topic so more research is needed. However, the few studies that show a difference between emerging and developed countries show that there exists a negative relationship between ESG performance and dividend payout in emerging countries, in contrast to the general, positive relationship that is present in most literature. Therefore, the same relationship is expected in this research. This leads to the formulation of the second null hypothesis and alternative hypothesis:

*Hypothesis 2a: ESG performance of firms in emerging countries is not negatively associated with dividend payout.*

*Hypothesis 2b: ESG performance of firms in emerging countries is negatively associated with dividend payout.*

The third hypotheses are related to the literature on ESG performance and market value. Friede et al. (2015) show that most studies about the relationship between ESG performance and market value found that ESG is positively associated with market value. According to Gillan et al. (2021), this is also supported by the theory. As with the relationship between ESG and dividends, the relationship found in the literature is expected to be found in this research as well. Therefore, the following null hypothesis and alternative hypothesis are formulated:

*Hypothesis 3a: ESG performance is not positively associated with market value.*

*Hypothesis 3b: ESG performance is positively associated with market value.*

The fourth null hypothesis and alternative hypothesis are related to the third hypotheses but will again dive deeper into the difference between emerging countries and developed countries. As with the relationship between ESG performance and dividend payout, there is also not a lot of research about the difference between emerging and developed countries in the relationship between ESG performance and market value. However, the small number of articles indicates that ESG practices of firms in emerging countries are negatively associated with market value. In the fourth hypotheses, it is expected that the same difference compared to prior research will be found. This means that the expectation is that the relationship between ESG performance and market value is negative for emerging countries. Therefore, the following null hypothesis and alternative hypothesis are formulated:

*Hypothesis 4a: ESG performance of firms in emerging countries is not negatively associated with market value.*

*Hypothesis 4b: ESG performance of firms in emerging countries is negatively associated with market value.*

## Chapter 3: Methodology

This chapter will discuss the data and methods that are used in this research. First of all, the regression models are presented in 3.1. After that, the dependent and independent variables used in the analysis will be described in 3.2. Furthermore, 3.3 will continue with a description of the two sub-samples that are necessary for the second and fourth hypotheses. Lastly, 3.4 will conclude with the control variables that are included in the different regression models.

### 3.1 Regression models

For the first hypotheses, the relationship between ESG performance and dividend payout will be investigated. Therefore, the analysis will be conducted by using Model (1):

$$(1) \quad DIV_{i,t} = \beta_0 + \beta_1 ESG_{i,t} + \beta_2 ROA_{i,t} + \beta_3 MTB_{i,t} + \beta_4 LEV_{i,t} + \beta_5 CASH_{i,t} + \beta_6 SIZE_{i,t} + \varepsilon_{i,t}$$

Here,  $DIV_{i,t}$  represents the dividend payout and  $ESG_{i,t}$  represents the ESG Combined Score.  $ROA_{i,t}$  represents Return On Assets,  $MTB_{i,t}$  represents Market To Book Value,  $LEV_{i,t}$  represents Leverage,  $CASH_{i,t}$  represents Cash Holdings and  $SIZE_{i,t}$  represents Firm Size. Lastly,  $\varepsilon_{i,t}$  is the error term. For all variables,  $i$  represents firm  $i$  and  $t$  represents year  $t$ . A description of all variables can be found in Table 1.

For the second hypotheses, the relationship between ESG performance and dividend payout will again be investigated. However, the difference with the first hypotheses is that the relationship for emerging countries will be specifically looked into. Therefore, Model (1) will be used, but the results will be shown for the two sub-samples as described in 3.3. As a result, the regression of Model (2) will firstly be performed on the condition that Emerging Country equals 1 and thereafter on the condition that Emerging Country equals 0.

The third hypotheses, through which the relationship between ESG performance and market value is investigated, will be tested with Model (2):

$$(2) \quad Q_{i,t} = \beta_0 + \beta_1 ESG_{i,t} + \beta_2 ROA_{i,t} + \beta_3 MTB_{i,t} + \beta_4 LEV_{i,t} + \beta_5 CASH_{i,t} + \beta_6 SIZE_{i,t} + \varepsilon_{i,t}$$

In this model,  $Q_{i,t}$  represents Tobin's  $Q$ , which is an indication of the long-term market value of a firm. The other variables in this model are the same as in Model (1). A description of all variables can be found in Table 1.

A similar analysis will be done for the fourth hypotheses to be able to analyze the possible difference between emerging and developed countries in the relationship between ESG performance and market value. For these hypotheses, Model (2) will be used, with the results shown for the two sub-samples which are described in 3.3. As a result, the regression of Model (2) will firstly be performed on the condition that Emerging Country equals 1 and thereafter on the condition that Emerging Country equals 0.

Table 1 Definition of variables

Variable	Abbreviation	Definition
Dividend Payout Ratio	DIV	The ratio of dividends and net income of a firm
Tobin's Q	Q	The ratio of total market value and total assets of a firm
ESG Combined Score	ESG	A score that combines self-reported ESG information of a firm and a firm's exposure to ESG controversies and negative events
Return On Assets	ROA	The ratio of operating income and total assets of a firm
Market To Book Value	MTB	The ratio of market value and book value of equity of a firm
Leverage	LEV	The ratio of total debt and book value of total assets of a firm
Cash Holdings	CASH	The ratio of cash and equivalents to total assets of a firm
Firm Size	SIZE	The natural logarithm of market value of equity of a firm

*Note.* This table defines the different variables that are used in Model (1) and Model (2). The first column gives the variable name. In Column 2, the abbreviation that is used in the regression model can be found. Lastly, a definition of the variable is given in Column 3.

### 3.2 Dependent and independent variables

The data that is used in this research comes from the Refinitiv Eikon database. This is a database that contains extensive data about ESG as well as financial information. Therefore, all the necessary information for this research can be found. The collected data from the Refinitiv Eikon database comes from the period 2017-2022. Therefore, a reliable period of 6 years can be used for the analysis. First of all, the ESG performance needs to be measured. This will be done by looking at an ESG indicator. The indicator that will be used is ESG Combined Score, which combines the ESG score with an ESG Controversies overlay. Therefore, it will both cover the self-reported information about environmental, social, and corporate governance pillars, as well as a company's exposure to environmental, social, and governance controversies and negative events reflected in global media. The ESG Combined Score ranges from 0 to 100, where a higher score means that a company performs better with regard to ESG.

Furthermore, the dividend payout needs to be used, to be able to compare the dividends that are paid by companies that perform well on ESG with the dividend paid by bad performing firms when it comes to ESG. The Dividend Payout Ratio that can be found in the Refinitiv Eikon database will be used in the analysis. It represents the ratio between dividends and net income of a firm. This is a variable that is often used to measure the dividend payout of a firm, for example by Samet and Jarbouï (2017). Moreover, market value will be measured by Tobin's Q, which represents the total market value divided by the total assets of a firm. Therefore, Tobin's Q can be seen as a reliable indicator of the long-term market value of a company (Zhou et al., 2022). The use of Tobin's Q is a common way of measuring market value in the literature (Gillan et al., 2021). Tobin's Q can not immediately be found in the Refinitiv Eikon database. However, it is possible to collect the total market value and the total assets of a firm, so that Tobin's Q can be calculated with the help of these two variables.

### 3.3 Developed or emerging country

The country where a firm operates is also necessary for the analysis. The country will be based on the place of the headquarters, as a good proxy for the country where the firm mainly operates. Although there will be cases where this is not the case, it is still the best way of determining whether the firm is operating in a developed country or an emerging country. To decide whether a country is developed or emerging, the Human Development Index (HDI) will be used. This index is published every year in the Human Development Report by the United Nations Development Programme. HDI is a summary measure of the human development of a country, by summarizing life expectancy, education, and living standards into one metric. This statistic ranges from 0 to 1, where the score is higher if a country is performing better. This means that a country is performing better in terms of human development if the life expectancy is higher, if the average person is higher educated, and if the living standards are higher. A country is considered developed if the HDI is higher than 0.8, while it is considered to be an emerging country with an HDI lower than 0.8. The latest available HDI is used, which comes from 2021.

Some firms operate in countries that are not acknowledged by the HDI so some adjustments were necessary. The four countries for which no HDI was available are: Bermuda, the Cayman Islands, Jersey, and Taiwan. Bermuda, the Cayman Islands, and Jersey are considered to be part of the United Kingdom so these are developed countries. In this research, Taiwan is considered to be part of China, so Taiwan is considered an emerging country. For the analysis, a dummy variable that tells whether a firm operates in a developed or an emerging country is added to the data. The dummy variable Emerging Country equals 1 if a firm operates in an emerging country, and equals 0 if it operates in a developed country. With the help of this dummy variable, two sub-samples are created. One sub-sample consists of firms that are headquartered in a developed country, while the other consists of firms that are headquartered in an emerging country. The breakdown of the data into developed or emerging countries can be seen in Table 2. A more extensive version of Table 2 can be found in the Appendix, as Table A1.

Table 2 Sample breakdown into firms operating in developed or emerging countries

	<b>Observations</b>	<b>Percentage</b>
Developed	1,018	79.53
Emerging	262	20.47
Total	1,280	100

*Note.* This table shows the breakdown of the full sample into firms headquartered in developed countries and emerging countries. The breakdown is done by looking at the HDI of a country, where a country is considered developed if the HDI is larger than 0.8 and emerging if the HDI is lower. Column 2 shows the number of observations in the sub-sample and Column 3 shows the percentage of the full sample in the sub-sample.

### 3.4 Control variables

To prevent omitted variable bias, five control variables will be used in the analysis. The control variables used in this research are in line with the model adopted by Samet and Jarboui (2017). As a result, the following control variables are used: Return On Assets, Market To Book Value, Leverage, Cash Holdings, and Firm Size. Profitability needs to be controlled for, as it is related to dividend payout as well as market value. It is established in the literature that firm performance is directly related to market value (Aouadi & Marsat, 2018). Dividend payout is also related to profitability, as more profitable firms can distribute more cash to their shareholders (De Cesari & Ozkan, 2015). In line with Aouadi and Marsat (2018), as well as Samet and Jarboui (2017), Return On Assets is included as a proxy for profitability and is directly available in the Refinitiv Eikon Database.

It is also necessary to control for growth opportunity, as there is a relationship between growth opportunity on the one hand, and dividend payout and market value on the other hand. The relationship between growth opportunity and dividend payout comes from the fact that firms with more growth potential are more likely to invest capital than to distribute it to shareholders (Samet & Jarboui, 2017). In contrast to this negative relationship, a positive relation between growth opportunity and market value is found in the literature. For firms with higher growth, a higher fraction of market value is derived from growth opportunities rather than assets so that higher growth opportunity is positively related to market value (Aouadi & Marsat, 2018). The proxy that is used for growth opportunity is Market To Book Value, in line with Samet and Jarboui (2017). This variable can also be found in the Refinitiv Eikon database.

The third relationship which needs to be controlled for is the leverage of a firm. Between dividend payout and leverage, the relationship established in the literature is negative. This means that firms with higher leverage, tend to pay out less dividends, as their financing costs are higher and leverage can act as a substitute for dividend payouts (De Cesari & Ozkan, 2015). The relationship that is found in the literature between market value and leverage is also negative. This is due to the fact that firms with higher leverage tend to have greater risks. These risks lower the firm's growth prospects and therefore its market value (Del Mar Miralles-Quirós et al., 2019). In contrast to Return On Assets and Market To Book Value, Leverage is not a variable that can be found in the Refinitiv Eikon Database. However, it can be calculated with variables from the database. As a result, the total debt is divided by the book value of the total assets to be able to control for the leverage of a firm.

Furthermore, it is necessary to control for cash holdings. The relationship between cash holdings and dividend payout is positive, as firms with more cash at hand, are more likely to engage in dividend payments (De Cesari & Ozkan, 2015). This is in contrast to the relationship between cash holdings and market value, as higher cash holdings are negatively related to market value because the cash holdings are not used to invest in growth opportunities (Kalcheva & Lins, 2007). It is again necessary to calculate

Cash Holdings, as no variable in the Refinitiv Eikon Database directly represents the ratio of cash and equivalents to total assets.

The last control variable that needs to be included in the model is firm size. There is a positive relationship between firm size and dividend payout, as larger firms tend to have lower financing costs and are therefore able to payout more dividends (De Cesari & Ozkan, 2015). It is also established that there is a relationship between firm size and market value, but the sign is ambiguous. Market value can decrease as a larger firm will be more diversified, but market value can also increase because of wider media and analyst coverage when a firm becomes larger (Aouadi & Marsat, 2018). The proxy for firm size is the natural logarithm of the market value of equity, in line with the model of Samet and Jarboui (2017). The market value of equity can be found in the Refinitiv Eikon database, and the natural logarithm is taken of this.

For this research, it is chosen to measure all variables at the end of the fiscal year, as this will make sure that it is possible to reliably compare between years. Moreover, the collected data is in euros. Only observations for which all variables were available in the Refinitiv Eikon database are used. As a result, some firms have six observations in the final sample (for every year an observation), while others have only one. The final sample consists of 1,280 observations, for which the descriptive statistics can be seen in Table 3.

Table 3 Descriptive statistics for regression variables

<b>Variable</b>	<b>Obs.</b>	<b>Mean</b>	<b>Std. Dev.</b>	<b>Min.</b>	<b>Max.</b>
Dividend Payout Ratio	1,280	219.13	3,149.33	0.00	81,981.74
Tobin's Q	1,280	1.32	1.68	0.03	24.44
ESG Combined Score	1,280	58.37	18.03	3.20	95.63
Return On Assets	1,280	7.02	6.01	0.03	55.73
Market To Book Value	1,280	3.24	4.34	0.21	53.87
Leverage	1,280	0.25	0.16	0.00	0.92
Cash Holdings	1,280	0.06	0.06	0.00	0.46
Firm Size	1,280	22.68	1.30	17.75	26.95
Emerging Country	1,280	0.20	0.40	0.00	1.00

*Note.* This table shows the descriptive statistics for the variables that are used in Model (1) and Model (2). The first column shows the different variables. In the second column, the number of observations can be found. The third column gives the mean, and Column 4 gives the standard deviation. Lastly, Column 5 gives the minimum value and the sixth column gives the maximum value in the sample.



## Chapter 4: Results

In this chapter, the results will be discussed. This will be done by looking at the four hypotheses, in the same order as they are presented in 2.4. The regression results of Model (1) will be presented in 4.1. Firstly, the first hypotheses will be discussed so that the entire sample is used. Thereafter, Model (1) will be applied to the two sub-samples which are described in 3.2 so that conclusions about the second hypotheses can be drawn. In 4.2, the results of the regression analysis of Model (2) will be discussed. This will again be done by first looking into the full sample so that the third hypotheses can be discussed. After that, the same two sub-samples as used in 4.1 are applied to Model (2) so that it is possible to draw conclusions about the fourth hypotheses. Every discussion of hypotheses will include a comparison with the theory described in Chapter 2. Lastly, this chapter will conclude with an overview of the null hypotheses that are rejected and those that are not rejected. Throughout the chapter, a significance level of 5% is used when discussing whether a relationship is statistically significant or not.

### 4.1 Regression results Model (1)

First of all, the first hypotheses needs to be assessed, which expects better ESG performance to be positively related to dividend payout. The results for the full sample can be seen in Column 1 of Table 4. It can be derived from the results that the ESG Combined Score of a firm has no significant relationship with the Dividend Payout Ratio of a firm. The theory on the other hand predicts that a higher ESG Combined Score increases dividends, as discussed in 2.2. This is however based on the assumption that the earnings channel dominates, which explains that better ESG performance increases earnings, which in turn increases dividends (Cheung et al., 2018). An explanation for the results presented in Column 1 of Table 4 might be that neither the earnings channel nor the equity cost of capital channel dominates in this sample. The equity cost of capital channel by Cheung et al. (2018) means that ESG performance lowers the cost of capital, which incentivizes firms to hold cash or invest instead of paying dividends. With the help of the regression results, it is not possible to reject the first null hypothesis that ESG performance is not positively associated with dividend payout.

Moreover, Leverage is the only control variable that is significantly and positively related to the Dividend Payout Ratio. This finding suggests that higher leverage is associated with a higher dividend payout, while the literature expects that firms with higher leverage tend to pay out fewer dividends, as their financing costs are higher and leverage can act as a substitute for dividend payouts (De Cesari & Ozkan, 2015). The other control variables are not significant, which means that there exists no relationship between the Dividend Payout Ratio on the one hand, and Return On Assets, Market To Book Value, Cash Holdings, and Firm Size on the other hand. As for the R-squared, it can be noticed that the value of 0.007 tells that the model can explain little of the data, which means that the explanatory value of the model is low.

Table 4 Linear regression results for the relationship between ESG Combined Score and Dividend Payout Ratio

Variable	Sample		
	Full (1)	Emerging Country (2)	Developed Country (3)
ESG Combined Score	-6.654 (5.197)	-0.151 (0.235)	-11.358 (7.187)
Return On Assets	-10.563 (19.054)	-1.015 (0.785)	-17.659 (26.459)
Market To Book Value	10.607 (25.424)	1.316 (0.925)	12.904 (37.976)
Leverage	1,203.829** (593.028)	-57.166** (28.691)	1,567.002** (767.584)
Cash Holdings	-683.355 (1,428.615)	2.234 (52.580)	-960.047 (2,141.021)
Firm Size	-35.982 (74.690)	-4.049 (3.990)	-23.789 (97.373)
Constant	1,205.983 (1,641.635)	172.649* (90.347)	1,227.140 (2,104.442)
Observations	1,280	262	1,018
R-squared	0.007	0.026	0.009
F-statistic	1.410	1.150	1.590

*Note.* This table shows the results of a linear regression which has ESG Combined Score as independent variable and Dividend Payout Ratio as dependent variable. Return On Assets, Market To Book Value, Leverage, Cash Holdings, and Firm Size are added as control variables. The constant, number of observations, R-squared, and F-statistic are also shown. In Column 1, all 1,280 observations are used and therefore represents the full sample. Column 2 consists only of firms that mainly operate in an emerging country and therefore has 262 observations. Lastly, Column 3 represents the sample that consists of firms which mainly operate in a developed country and therefore has 1,018 observations. Standard errors are in parentheses. \*  $p < 0.1$ , \*\*  $p < 0.05$  and \*\*\*  $p < 0.01$ .

The second hypotheses, which hypothesizes that ESG performance of firms in emerging countries is negatively associated with dividend payout, can be assessed with the results in Columns 2 and 3 of Table 4. From Column 2 of Table 4, it can be derived that there exists no significant relationship between the ESG Combined Score and the Dividend Payout Ratio of a firm that mainly operates in an emerging country. This is unexpected from the theory, as the studies that investigated the difference between emerging countries and developed countries found a negative relationship between ESG

performance and dividend payout in emerging countries. However, these authors found a positive relationship in their full sample and also in the sample with only firms that operate in developed countries. As can be seen in Columns 1 and 3 of Table 4, there exists no relationship at all in the sample that is used in this research. With the results, it is not possible to reject the null hypothesis that ESG performance of firms in emerging countries is not negatively associated with dividend payout.

As for the control variables, it can be seen that Leverage is significant and negative for the Emerging Country sample, which is in line with the theory, while the relationship is significant and positive for the full and the Developed Country sample. The other control variables are not significant, which means that there exists no relationship between the Dividend Payout Ratio of firms in emerging countries on the one hand, and Return On Assets, Market To Book Value, Cash Holdings, and Firm Size of firms in emerging countries on the other hand. Lastly, it can be noticed that the R-squared of the regression model performed with the Emerging Country sample is almost four times as high as the model with the full sample and almost three times as high as the model with the Developed Country sample. Therefore, it can explain more of the data, although it is still very low.

## **4.2 Regression results Model (2)**

For the third hypotheses, which expects that ESG performance is positively associated with market value, the results in Column 1 of Table 5 can be used. It can be seen that the ESG Combined Score is significantly and negatively associated with Tobin's Q. Although the theory also predicts a significant relationship between ESG performance, most studies that investigate this found a positive relationship (Friede et al., 2015). The results of the regression analysis of the full sample thus contradict the expectations arising from the literature. A possible explanation for the negative relationship is that it is the result of mandatory ESG laws, or that it is only present in the short-term, as explained by Christensen et al. (2021).

Although it is thus established that there exists a significant and negative relationship between the ESG Combined Score and Tobin's Q of a firm, it can be seen that a one-point increase in the ESG Combined Score (on a scale from 0-100) decreases Tobin's Q with only 0.004. Therefore, it can be said that the relationship is statistically significant, but economically insignificant. With the regression results of Column 1 of Table 5, it is not possible to reject the null hypothesis that ESG performance is not positively associated with market value. In fact, the opposite is true, as it would be possible to say that ESG performance is negatively associated with market value but no such hypotheses were formulated. As for the control variables, it can be seen that Return On Assets and Market To Book Value are significantly and positively associated with Tobin's Q. This means that higher profitability and growth opportunity are related to higher market value, which is also expected from the literature. Moreover, the control variable Leverage is significant and negative, which means that firms with higher leverage are

associated with lower market value, as expected from the literature. The control variables Cash Holdings and Firm Size are not significant, which means that there is no relationship between them and the market value of a firm. Lastly, the R-squared value of 0.798 means that the model can explain almost 80% of the data, which is rather high.

Table 5 Linear regression results for the relationship between ESG Combined Score and Tobin's Q

Variable	Sample		
	Full (1)	Emerging Country (2)	Developed Country (3)
ESG Combined Score	-0.004*** (0.001)	-0.002 (0.002)	-0.005*** (0.001)
Return On Assets	0.061*** (0.005)	0.037*** (0.007)	0.077*** (0.005)
Market To Book Value	0.281*** (0.006)	0.357*** (0.008)	0.220*** (0.008)
Leverage	-1.428*** (0.143)	-1.344*** (0.261)	-1.198*** (0.159)
Cash Holdings	0.422 (0.344)	-1.023** (0.478)	0.671 (0.130)
Firm Size	0.018 (0.018)	-0.004 (0.036)	0.056*** (0.020)
Constant	0.192 (0.395)	0.494 (0.821)	-0.627 (0.149)
Observations	1,280	262	1,018
R-squared	0.798	0.931	0.728
F-statistic	839.890	568.550	451.250

*Note.* This table shows the results of a linear regression which has ESG Combined Score as independent variable and Tobin's Q as dependent variable. Return On Assets, Market To Book Value, Leverage, Cash Holdings, and Firm Size are added as control variables. The constant, number of observations, R-squared, and F-statistic are also shown. In Column 1, all 1,280 observations are used and therefore represents the full sample. Column 2 consists only of firms that mainly operate in an emerging country and therefore has 262 observations. Lastly, Column 3 represents the sample that consists of firms which mainly operate in a developed country and therefore has 1,018 observations. Standard errors are in parentheses. \*  $p < 0.1$ , \*\*  $p < 0.05$  and \*\*\*  $p < 0.01$ .

Lastly, the fourth hypotheses can be assessed, which expects that ESG performance of firms in emerging countries is negatively associated with market value. It can be seen in Column 2 of Table 5 that the relationship between ESG Combined Score and Tobin's Q of a firm operating in an emerging country is not significant. This result is not in line with the theory, as it was expected that firms operating in emerging countries have a significant and negative relationship between ESG performance and market value. However, when looking at the Developed Country sample in Column 3 of Table 5, it can be seen that there is a significant and negative relationship. This is even more surprising, as the expectation that arises from the literature was that the full sample and the Developed Country sample would show a significant positive relationship, while the Emerging Country sample would then show a significant negative relationship. There is thus again a contradiction between the regression results of the sample used and the theory. Christensen et al. (2021) give a possible explanation for the contradiction that this is the result of mandatory ESG laws in developed countries, or that it is only the short-term so that the same significant negative relationship in emerging countries will be found in the future. However, these regression results cannot lead to rejecting the null hypothesis which states that ESG performance of firms in emerging countries is not negatively associated with market value. In fact, it would be possible to say that ESG performance of firms in developed countries is negatively associated with market value but this was not formulated as a hypothesis.

When looking at the control variables, it can firstly be seen that there is a significant and positive relationship between Return On Assets and Tobin's Q of firms in emerging countries. A firm's profitability is thus positively associated with the market value of a firm operating in an emerging country, which is in line with the theory. Moreover, the Market To Book Value and Tobin's Q of firms in emerging countries are also significantly and positively related. This means that higher growth opportunities are associated with a higher market value in emerging countries, as expected from the literature. The control variable Leverage is significantly and negatively related to Tobin's Q in emerging countries, which means that firms with higher leverage are associated with lower market value, as expected from the literature. The same goes for Cash Holdings, as this control variable is also significantly and negatively associated with Tobin's Q in emerging countries, which was also expected from the theory. The last control variable Firm Size is not significant in the Emerging Country sample, although it is significant and positive in the Developed Country sample. Lastly, the R-squared of 0.931 in Column 2 of Table 5 tells that 93.1% of the data can be explained by the regression model, which is a high value. The R-squared of the Developed Country sample is lower than that of the full sample on the other hand, as the 0.728 in Column 3 of Table 5 is lower than the 0.798 in Column 1 of Table 5.

### **4.3 Conclusion about hypotheses**

Now that the results of Model (1) and Model (2) are discussed, it is possible to give an overview of the rejected and not rejected null hypotheses. For the first hypotheses, it was expected that ESG performance is positively related to dividend payout. However, there was no significant relationship found in the full sample for Model (1), which means that it is not possible to reject the first null hypothesis that ESG performance is not positively associated with dividend payout. Model (1) was also used for the second hypotheses, although the sample was therefore divided into emerging and developed countries. It was expected that ESG performance of firms in emerging countries is negatively associated with dividend payout. However, it was found that there exists no significant relationship between ESG performance of firms in emerging countries with the dividend payout. Therefore, it is not possible to reject the second null hypothesis that ESG performance of firms in emerging countries is not negatively associated with dividend payout.

As for the third hypotheses, it was expected that ESG performance would be positively related to market value. When Model (2) was applied to the full sample, there was a significant relationship found. However, in contrast to the expectation from the theory and prior research, ESG performance is negatively associated with market value in the full sample. As a result, it is not possible to reject the third null hypothesis that ESG performance is not positively associated with market value. Lastly, the fourth hypotheses can be assessed by looking at the results for Model (2), with the sample breakdown into emerging and developed countries. The expectation was that ESG performance of firms in emerging countries is negatively associated with market value. However, there is not a significant relationship found between ESG performance and market value for the sample with emerging countries. For the sample with developed countries, there was a significant and negative relationship between ESG performance and market value, but there were no hypotheses formulated for the developed countries. As a result, it is not possible to reject the fourth null hypothesis which stated that ESG performance of firms in emerging countries is not negatively associated with market value.

## Chapter 5: Conclusion

The interest in ESG activities has increased over the last decades, as more and more actors feel the need to contribute to a more sustainable world, including voluntary actions by firms. If these activities are bad for shareholders, firms should not undertake them according to the neoclassical shareholder theory. The stakeholder theory on the other hand states that companies should always undertake ESG activities, as a way to create value for their stakeholders. This thesis has investigated whether the two theories are contradicting or in fact in line with each other. It is researched by looking at the relationship between ESG performance and shareholder returns. If it is found that the relationship is positive, this would mean that the neoclassical shareholder theory and the stakeholder theory are in line with each other, as creating value for stakeholders would then also increase the value for shareholders.

The research is concentrated on the following central research question:

*What is the relationship between ESG performance and the returns of shareholders?*

The returns of shareholders consist of two parts, which are dividend payout and capital growth. By looking at the relationship between ESG performance on the one hand, and dividend payout and market value on the other hand, it is possible to conclude about the overall relationship. It is found that ESG performance is not statistically significantly associated with dividend payout. For the relationship between ESG performance and market value, a statistically significant relationship is found, but it is not economically significant. As a result, it is hard to conclude that there is a relationship between ESG performance and the returns of shareholders at all, in the used sample. However, it is certainly not a positive relationship, which was expected from earlier research. Also when specifically looking at firms operating in emerging countries, there was no significant relationship found between ESG performance on the one hand and dividend payout and market value on the other hand. This was in contrast to the negative relationship that was found in earlier research.

The results of this research imply that firms undertaking ESG activities are not creating value for their shareholders. Therefore, supporters of the neoclassical shareholder theory will conclude that firms should not undertake these activities. Supporters of the stakeholder theory on the other hand will state that firms should nevertheless undertake ESG activities, as it creates value for other stakeholders. Thus, it can be concluded that the theories have a different viewpoint on ESG activities but this is based on the assumption that the results are valid and unbiased. One that uses the results of this research to conclude such things should therefore take the limitations into account. The first limitation is that there might have been selection bias. As explained earlier, only observations for which all variables were available in the Refinitiv Eikon database were selected. This might have led to excluding observations for which the opposite relationship was present, compared to the one found in the sample. If true, the exclusion will then have led to biased results. Moreover, the used research method might have been unsuitable. Since only a simple linear regression is used, it is impossible to make any causal statements.

Although this was also not the purpose of the research, it would still be better if it was possible to make causal statements. The problem that occurs in this study, and also in prior research, is that most data is only suitable for linear regressions, and not for any causal study methods.

Future research into the topic of this study is necessary. First of all, future research can try to capture the relationship that is examined in this research, with the avoidance of the aforementioned limitations. The first limitation can be avoided by the usage of a more complete dataset so that no observations need to be excluded. It is more problematic to avoid the second limitation, as finding a suitable method for making causal statements is difficult. However, as more and more firms are mandated to publish ESG information in their annual reports, it might become possible in the near future. A second line of research can dive specifically into the difference between emerging and developed countries. The results of this study show no significant relationship for emerging countries, both for the dividend payout and for the market value. A significant and negative relationship was found between ESG performance and market value for firms operating in developed countries. This result was in contrast to earlier research, as most studies show a negative relationship between ESG performance and financial performance in emerging countries and a positive relationship in developed countries. Therefore, more research into the difference between emerging and developed countries is needed. Lastly, more research that focuses on the combination of dividend and capital growth in relationship with ESG performance should be conducted. Most studies only look at one of the two variables in relationship with ESG performance, while a combination of the two is necessary to conclude about the returns of shareholders.



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# Appendix

Table A1 Sample breakdown by country

	<b>Observations</b>	<b>Percentage</b>
<b>Developed</b>	<b>1,018</b>	<b>79.53</b>
Australia	226	17.66
Austria	9	0.70
Belgium	16	1.25
Canada	28	2.19
Chile	20	1.56
Cyprus	3	0.23
Denmark	18	1.41
Finland	9	0.70
France	120	9.38
Germany	26	2.03
Greece	10	0.78
Hong Kong	64	5.00
Hungary	1	0.08
Ireland	1	0.08
Italy	22	1.72
Luxembourg	4	0.31
Malaysia	46	3.59
Netherlands	16	1.25
New Zealand	18	1.41
Norway	10	0.78
Poland	5	0.39
Saudi Arabia	6	0.47
Singapore	25	1.95
South Korea	79	6.17
Spain	13	1.02
Sweden	22	1.72
Switzerland	50	3.91
Thailand	15	1.17
Turkey	3	0.23
United Kingdom	114	8.91

United States of America	19	1.48
<b>Emerging</b>	<b>262</b>	<b>20.47</b>
Brazil	25	1.95
China	159	12.42
Colombia	2	0.16
Egypt	9	0.70
India	22	1.72
Indonesia	19	1.48
Mexico	11	0.86
Morocco	1	0.08
Philippines	8	0.63
South Africa	6	0.47
<b>Total</b>	<b>1,280</b>	<b>100</b>

*Note.* This table gives the sample breakdown into the two sub-samples, and then further divides it into the country where the firm is headquartered. The first column gives the country where a firm is headquartered, and also has a row for developed and emerging countries, and one for the full sample. In Column 2, the number of observations can be found. Lastly, Column 3 tells the percentage of the full sample that a country represents.