

DOES ESG PERFORMANCE IMPROVE STOCK RETURNS? A SYSTEMATIC REVIEW OF EVIDENCE, MECHANISMS, AND CONTEXT

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Abstract

This study examines how Environmental, Social, and Governance (ESG) performance influences stock returns across different market conditions and firm characteristics. Using a systematic literature review based on PRISMA guidelines, this study synthesizes empirical evidence from 32 Scopus-indexed studies published between 2016 and 2026. The findings indicate that the relationship between ESG performance and stock returns is heterogeneous and context-dependent. While several studies report that ESG improves stock resilience, reduces downside risk, and supports better market performance during periods of crisis or high uncertainty, others find insignificant or negative effects, particularly in stable market conditions or in the short term. The results show that ESG effectiveness is shaped by market conditions, firm size, sectoral exposure, ESG measurement approaches, and methodological design. ESG appears to function more strongly as a risk mitigation and resilience mechanism than as a consistent source of abnormal returns. This study contributes to the sustainable finance literature by providing a structured synthesis of ESG–stock return evidence and highlighting the importance of contextual factors in explaining mixed empirical findings. The findings also offer practical insights for investors, portfolio managers, and policymakers in integrating ESG considerations into investment decision-making and risk management.

Keywords: ESG performance, stock returns, systematic literature review, PRISMA, sustainable finance

INTRODUCTION

The integration of Environmental, Social, and Governance (ESG) factors into investment decision-making has become a central theme in contemporary financial markets. ESG considerations have evolved from a niche ethical concern into a mainstream investment strategy adopted by institutional investors, asset managers, and regulatory bodies worldwide. This shift is not only driven by ethical considerations but also by the recognition that sustainability-related risks—such as climate change, corporate governance failures, and social inequalities—can materially affect firm value, risk exposure, and long-term financial performance. As a result, ESG is increasingly embedded into portfolio construction, risk management frameworks, and regulatory policies across global financial systems.

Despite the growing prominence of ESG investing, the empirical evidence on its relationship with stock returns remains inconclusive. While some studies report a positive association between ESG performance and stock returns, suggesting that sustainable firms are rewarded by the market (Xu, 2023; Lööf, 2022), others find negative or insignificant effects, arguing that ESG initiatives may impose additional costs or are not fully priced by investors (Samaniego, 2022; Williams, 2022). Moreover, a substantial portion of the literature reports mixed findings, indicating that the ESG–return relationship is highly context-dependent (Cho, 2023; Demir, 2021). This divergence suggests that ESG may not operate as a universal return-enhancing factor, but rather as a conditional determinant influenced by multiple external and internal variables.

This inconsistency highlights a critical gap in the literature. The impact of ESG on stock returns may vary depending on external conditions, such as market uncertainty, economic crises, and investor sentiment, as well as internal firm characteristics, including firm size, industry exposure, and financial fundamentals. For instance, ESG performance has been shown to enhance stock resilience during periods of crisis, such as the COVID-19 pandemic, where firms with strong ESG profiles tend to exhibit lower volatility and better downside protection (Chen, 2022; Xu, 2023). However, under stable market conditions, ESG effects appear weaker, less consistent, or even insignificant, indicating that the valuation of ESG factors by investors is dynamic rather than static.

Given these fragmented findings, a systematic synthesis of the existing literature is necessary to provide a comprehensive understanding of how ESG influences stock returns. Prior studies tend to focus on specific markets, sectors, or methodological approaches, limiting the ability to generalize findings across contexts. Therefore, this study aims to conduct a systematic literature review (SLR) to examine the relationship between ESG performance and stock returns across different market conditions and firm characteristics. By integrating evidence across diverse contexts, this study seeks to provide a more holistic and structured understanding of the ESG–stock return nexus.

The novelty of this study lies in its integrative approach, which simultaneously examines the ESG–stock return relationship by incorporating both market conditions (e.g., crisis versus non-crisis periods) and firm-specific characteristics (e.g., firm size and industry exposure). Unlike prior studies that tend to focus on a single dimension or isolated empirical setting, this study provides a more comprehensive synthesis that captures the conditional and multidimensional nature of ESG effects in financial markets. In doing so, the study moves beyond simplistic linear interpretations and highlights the importance of contextual factors in shaping ESG outcomes.

This study contributes to the literature in three ways. First, it provides a structured and systematic overview of empirical findings on ESG and stock returns, consolidating evidence from diverse methodological and geographical contexts. Second, it identifies the key contextual factors that explain the variation in results across studies, including market conditions, firm characteristics, and ESG measurement approaches. Third, it highlights critical research gaps and proposes directions for future research, particularly in addressing endogeneity issues, improving ESG measurement consistency, and incorporating dynamic market conditions.

From a practical perspective, the findings offer important implications for investors, portfolio managers, and policymakers. ESG should not be interpreted as a guaranteed source of superior returns, but rather as a strategic tool for enhancing risk management, improving resilience, and supporting long-term investment decision-making, particularly under conditions of market uncertainty. Investors may benefit from integrating ESG considerations alongside traditional financial metrics, especially in managing downside risks and navigating volatile market environments.

The scope of this study is limited to empirical studies indexed in the Scopus database published between 2016 and 2026, focusing specifically on ESG-related variables and stock return outcomes. By restricting the analysis to peer-reviewed studies within this period, the review ensures both the relevance and quality of the included evidence. However, this scope also implies that findings should be interpreted within the context of the selected database and time frame.

LITERATURE REVIEW

The concept of Environmental, Social, and Governance (ESG) has become increasingly central in modern financial research, particularly in understanding how non-financial factors influence firm performance and investment outcomes. ESG reflects a firm's commitment to sustainability practices, ethical governance, and social responsibility, which are believed to enhance long-term value creation and reduce firm-specific risks. From a theoretical perspective, ESG is often associated with stakeholder theory, which posits that firms that effectively manage relationships with stakeholders are more likely to achieve superior performance and sustainability outcomes (El

Khoury, 2021). In addition, signaling theory suggests that ESG disclosure provides valuable information to investors, reducing information asymmetry and improving market perception of firm quality (Cho, 2023).

From a financial perspective, ESG performance is expected to influence stock returns through several mechanisms. First, ESG can reduce risk exposure by improving operational efficiency, strengthening governance structures, and mitigating environmental and social liabilities. Second, ESG may enhance corporate reputation, thereby attracting long-term investors and increasing demand for the firm's stock. Third, ESG can influence the cost of capital, as firms with better ESG performance are perceived as less risky and more sustainable (Löf, 2022; Demir, 2021). However, the extent to which these mechanisms translate into higher stock returns remains an ongoing debate in the literature.

Empirical evidence on the ESG–stock return relationship shows mixed and often contradictory findings. Several studies document a positive relationship, indicating that firms with higher ESG scores tend to exhibit stronger stock performance and greater resilience, particularly during periods of market stress (Xu, 2023; Chen, 2022). These findings suggest that ESG can serve as a form of downside protection, reducing volatility and enhancing stability during uncertain market conditions. In contrast, other studies report negative or insignificant relationships, arguing that ESG investments may involve additional costs or that ESG information is not fully incorporated into stock prices (Samaniego, 2022; Williams, 2022; Trisnowati, 2022). This divergence indicates that ESG does not universally lead to superior financial performance.

A substantial portion of the literature highlights that the ESG–stock return relationship is highly dependent on contextual factors. Market conditions, such as economic crises or periods of high uncertainty, play a critical role in shaping the effectiveness of ESG. For example, ESG performance has been shown to provide stronger benefits during crisis periods, such as the COVID-19 pandemic, when investors place greater emphasis on risk management and firm resilience (Xu, 2023; Chen, 2022). Conversely, in stable or bullish market conditions, ESG effects are often weaker or inconsistent, as investors tend to prioritize short-term financial performance over sustainability considerations (Williams, 2022; Cho, 2023).

Firm-specific characteristics also influence the extent to which ESG affects stock returns. Larger firms tend to benefit more from ESG performance due to greater visibility, stronger institutional investor attention, and more comprehensive ESG disclosures (Cho, 2023). Additionally, ESG effects are more pronounced in industries with higher environmental and social exposure, such as energy, transportation, and financial services, where sustainability risks are more material (El Khoury, 2021). Furthermore, differences in ESG measurement approaches, including ESG scores, ratings, disclosure indices, and individual ESG dimensions, contribute to inconsistencies in empirical findings across studies (Demir, 2021; Williams, 2022).

Despite the growing body of literature, several research gaps remain. First, there is no consensus regarding the direction and magnitude of the ESG–stock return relationship. Second, many studies focus on specific countries, sectors, or short time periods, limiting the generalizability of findings. Third, the interaction between market conditions and firm characteristics is often examined separately rather than within an integrated framework. These gaps highlight the need for a systematic and comprehensive synthesis of the literature to better understand the conditional nature of ESG effects on stock returns.

Given that this study adopts a systematic literature review (SLR) approach, it does not aim to test specific hypotheses but rather to synthesize existing empirical evidence. Therefore, hypothesis formulation is not required in this study, as the focus is on identifying patterns, inconsistencies, and research gaps in the ESG–stock return relationship across different contexts.

RESEARCH METHODS

Review Methodology

This study employs a systematic literature review (SLR) approach to synthesize empirical evidence on the relationship between ESG performance and stock returns. The SLR method was selected because it enables a structured, transparent, and replicable process for identifying, selecting, evaluating, and synthesizing relevant studies (Tranfield et al., 2003; Snyder, 2019). This approach is particularly

appropriate because the literature on ESG and stock returns contains heterogeneous findings across countries, sectors, market conditions, ESG measurements, and empirical designs.

The review was conducted in accordance with the Preferred Reporting Items for Systematic Reviews and Meta-Analyses (PRISMA) guidelines, which provide a standardized framework for reporting systematic reviews (Moher et al., 2009; Page et al., 2021). The PRISMA framework was used to guide the stages of article identification, screening, eligibility assessment, and inclusion. By applying PRISMA, this study seeks to improve transparency, minimize selection bias, and enhance the reproducibility of the review process.

Following the PRISMA framework, the study selection process was conducted through a sequential procedure. In the identification stage, relevant articles were retrieved from the Scopus database using predefined keywords related to ESG performance and stock returns. The retrieved articles were then screened based on titles and abstracts to remove duplicates and exclude studies that were not aligned with the research topic. Subsequently, potentially relevant articles were assessed through full-text eligibility review using predefined inclusion and exclusion criteria. Only studies that explicitly examined the relationship between ESG-related factors and stock return measures were retained for the final synthesis.

Formulation of the Research Question

The research question was formulated using the SPIDER framework, which includes five core elements: Sample (S), Phenomenon of Interest (PI), Design (D), Evaluation (E), and Research Type (R). SPIDER is suitable for systematic reviews that include heterogeneous research designs and mixed forms of empirical evidence. The following aspects were considered: S: publicly listed companies, stocks, or stock markets; PI: ESG practices, ESG scores, ESG ratings, ESG disclosure, or ESG integration; D: empirical, comparative, conceptual, and literature review studies; E: stock returns, abnormal returns, risk-adjusted returns, and excess returns; and R: quantitative, qualitative, and mixed-method studies.

Based on this framework, the research question was formulated as follows: How does ESG performance influence stock returns across different market conditions and firm characteristics?

Population and Sample

The population of this study consists of peer-reviewed academic articles examining the relationship between ESG-related factors and stock market outcomes. The research target includes studies discussing publicly listed companies, stocks, stock markets, and ESG-related investment outcomes. The final sample consists of 32 empirical studies selected from the Scopus database after applying the predefined inclusion and exclusion criteria.

These studies were selected because they directly examine ESG-related variables, such as ESG performance, ESG scores, ESG ratings, ESG disclosure, ESG practices, or ESG dimensions, in relation to stock return measures. The selected articles therefore represent the empirical evidence base used to answer the research question. The use of peer-reviewed Scopus-indexed studies was intended to ensure that the final sample reflected academically credible and relevant sources.

Search Strategy and Data Collection

A comprehensive and systematic bibliographic search was conducted using the Scopus database to identify relevant studies published between 2016 and 2026. Scopus was selected because it provides broad coverage of peer-reviewed journals across business, management, finance, economics, and sustainability-related disciplines. The search strategy was developed using keywords derived from the research question and the SPIDER framework. The main search terms included “ESG,” “ESG performance,” “ESG score,” “ESG rating,” “ESG disclosure,” “environmental social governance,” “corporate sustainability,” “stock return,” “abnormal return,” “risk-adjusted return,” “excess return,” “market condition,” “financial crisis,” “COVID-19,” “emerging market,” “developed market,” “firm size,” “firm characteristics,” “industry effect,” and “sector.” These terms were combined using Boolean

operators to ensure that the search captured studies examining the relationship between ESG-related factors and stock return measures.

The search query applied in Scopus was as follows:

("ESG" OR "ESG performance" OR "ESG score" OR "ESG rating" OR "ESG disclosure"
OR "environmental social governance" OR "corporate sustainability")
AND
("stock return*" OR "abnormal return*" OR "risk-adjusted return*" OR "excess return*")
AND
("market condition*" OR "financial crisis" OR "COVID-19" OR "bull market"
OR "bear market" OR "emerging market*" OR "developed market*" OR "firm size"
OR "firm characteristic*" OR "industry effect*" OR sector*)

Following the database search, all retrieved records were exported and screened systematically. In the first stage, duplicate records were removed. In the second stage, titles and abstracts were reviewed to exclude studies that did not discuss ESG-related factors, stock return measures, publicly listed companies, or stock market outcomes. In the third stage, potentially relevant articles were assessed through full-text review using predefined inclusion and exclusion criteria. This process followed systematic review recommendations that emphasize explicit search procedures, transparent selection criteria, and replicable documentation (Tranfield et al., 2003; Snyder, 2019).

Criteria and process

Inclusion criteria: Studies were included if they were peer-reviewed journal articles published in English between 2016 and 2026, available in full text, and indexed in Scopus. Eligible studies had to examine ESG-related factors, including ESG performance, ESG scores, ESG ratings, ESG disclosure, ESG practices, or ESG dimensions, in relation to stock market outcomes. The studies also had to assess stock return measures, such as stock returns, abnormal returns, excess returns, risk-adjusted returns, stock performance, or market reaction, using empirical quantitative methods, including panel regression, event study, portfolio analysis, difference-in-differences, or other econometric approaches. These criteria were established to ensure that the included studies were directly aligned with the research question and the SPIDER framework used in this review.

Exclusion criteria: Studies were excluded if they did not directly examine the relationship between ESG-related factors and stock return outcomes. Articles focusing only on accounting-based performance, such as ROA, ROE, profitability, Tobin's Q, or firm value, without linking ESG to stock returns were not considered. Studies focusing exclusively on corporate reputation, knowledge capital, organizational capital, non-financial disclosure, ESG indices without firm-level or stock return analysis, book chapters, conference papers, editorials, commentaries, conceptual articles, protocols, and non-peer-reviewed publications were also excluded. Review articles were not included in the final synthesis because this review aimed to synthesize primary empirical evidence.

The inclusion and exclusion process followed the PRISMA approach, which emphasizes transparent reporting of study identification, screening, eligibility assessment, and inclusion in systematic reviews (Moher et al., 2009; Page et al., 2021). This procedure is also consistent with systematic review guidance in management research, which recommends explicit eligibility criteria to improve rigor, transparency, and replicability (Tranfield et al., 2003; Snyder, 2019).

Data Extraction

Data from the selected studies were extracted using a structured data extraction form. The extracted components included the name of the first author and publication year, research objective, research design, research location, population or research subject, ESG-related treatment or exposure, dependent variable or outcome, main findings, and study limitations. This extraction structure was designed to ensure that each study could be compared systematically based on its relevance to the research question.

The extraction process also allowed this review to identify differences in ESG measurement, stock return proxies, methodological approaches, market contexts, and firm-level characteristics across studies. This structured extraction approach supports systematic comparison and helps reduce subjectivity in the synthesis process. It also ensures that the synthesis is based on comparable evidence rather than selective interpretation.

Evaluation of risk of bias and methodological quality of studies

The methodological quality and risk of bias of the included studies were assessed using the Mixed Methods Appraisal Tool (MMAT) 2018, which is suitable for evaluating empirical studies with diverse research designs, particularly quantitative and mixed-method studies commonly used in finance and management research (Hong et al., 2018). The assessment was conducted systematically to ensure that only studies with acceptable methodological rigor were included in the synthesis. This quality appraisal step was necessary because the included studies differ in terms of sample size, research design, ESG measurement, stock return proxies, and econometric techniques.

Each study was evaluated based on key criteria, including the clarity of the research question, appropriateness of the study design, adequacy of data collection, validity of ESG and stock return measurements, and robustness of the analytical methods. To facilitate comparison across studies, the quality of each article was categorized into three levels: high quality ($\geq 80\%$), moderate quality (60%–79%), and low quality ($< 60\%$). This quality appraisal process was conducted in line with systematic review standards to enhance transparency, reduce bias, and improve the reliability of the synthesized findings (Page et al., 2021; Tranfield et al., 2003).

Assessment of evidence certainty

In this systematic review, the certainty of evidence was assessed using the framework developed by the Oxford Centre for Evidence-Based Medicine (OCEBM) (Howick et al., 2011), adapted to the context of empirical financial research. Given that the included studies primarily employ observational and econometric designs, the initial level of evidence was generally classified within moderate tiers. However, the level of evidence for each study was further evaluated and, where necessary, adjusted based on methodological rigor, robustness of econometric techniques, consistency of findings, sample size, and the appropriateness of ESG and stock return measurements.

Studies employing advanced methodologies, such as panel regression with fixed effects, difference-in-differences, event study, or regime-switching models, and providing consistent, well-supported results were considered to offer higher certainty of evidence. Conversely, studies with limited samples, short observation periods, crisis-specific designs, or potential endogeneity concerns were considered to provide lower certainty. This approach ensures that the synthesis reflects not only the direction of findings but also the strength and reliability of the underlying evidence, in line with best practices in systematic review research (Tranfield et al., 2003; Snyder, 2019).

Data Analysis and Synthesis

Data from the selected articles were systematically summarized in structured tables, including information on authors, publication year, country, research design, sample characteristics, ESG measurement, stock return proxies, research objectives, main findings, and limitations. In addition, the methodological quality, risk of bias, and certainty of evidence for each study were documented to support the interpretation of the results. This process enabled the review to compare studies across different methodological designs and contextual settings.

To synthesize the findings, a vote-counting approach was employed following the Synthesis Without Meta-analysis (SWiM) guidelines, which are appropriate when heterogeneity across studies prevents quantitative meta-analysis (Campbell et al., 2020; McKenzie & Brennan, 2019). Specifically, the effects of ESG on stock returns were categorized based on the direction of the reported results as positive (+), negative (–), or non-significant/mixed ($\pm$), depending on the dominant findings within each study. Furthermore, studies were grouped according to key contextual dimensions, including market

conditions, market types, and firm characteristics, to identify patterns and sources of variation. The results were then synthesized narratively and supported by tabular summaries to provide a comprehensive interpretation of the ESG–stock return relationship across different contexts.

RESULT AND DISSCUSION

Study Selection

The study selection process followed the PRISMA framework to ensure transparency, replicability, and systematic reporting of the review process (Moher et al., 2009; Page et al., 2021). The search was conducted in the Scopus database using predefined keywords related to ESG performance, stock returns, market conditions, and firm characteristics. The search was limited to peer-reviewed journal articles published between 2016 and 2026 to ensure that the reviewed studies reflected recent developments in ESG investing and capital market research.

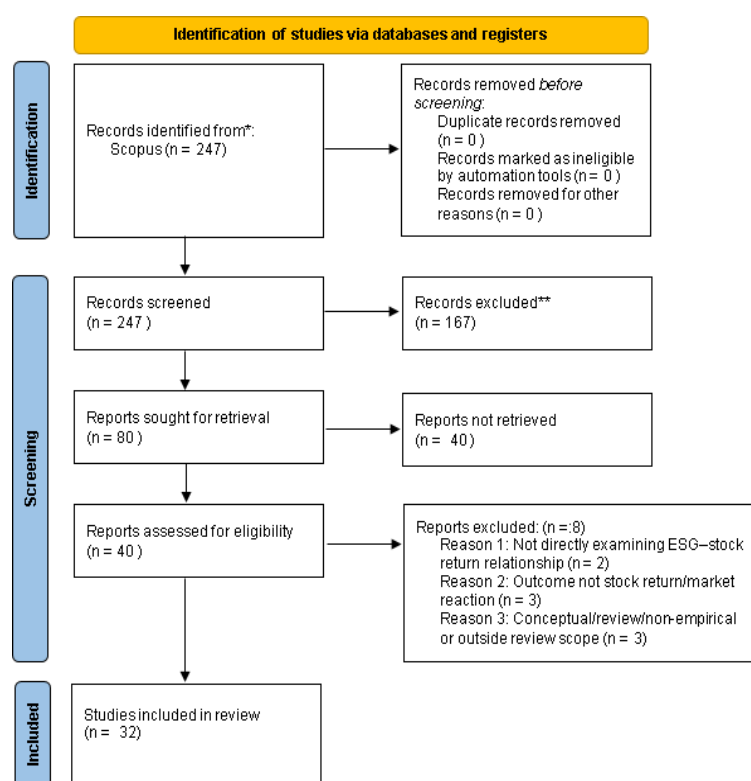


Figure 1. PRISMA flow diagram of the study selection process

As shown in Figure 1, the Scopus search identified 247 records. After title and abstract screening, 167 records were excluded, leaving 80 reports for retrieval. Of these, 40 full-text articles were assessed for eligibility, and 8 were excluded based on the predefined criteria. Consequently, 32 studies were included in the final synthesis.

Characteristics of Included Studies

The 32 included studies cover developed, emerging, and multi-country market contexts, providing a broad view of ESG–stock return dynamics across different institutional and regulatory settings. These variations are important because ESG adoption, disclosure quality, and investor awareness may differ across markets (Cho, 2023; Trisnowati, 2022; Xu, 2023). Table 1 summarizes the included studies based on market coverage, research design, ESG proxy, outcome variable, and direction of findings.

Table 1. Summary Characteristics of Included Studies

Category	Classification	Total	Percentage
Market coverage	Developed markets	10	31%
	Emerging markets	14	44%
	Multi-country / global / regional	8	25%
	Total	32	100%
Research design	Panel / regression	15	47%
	Event study	6	19%
	Portfolio / asset pricing / risk return analysis	5	16%
	Difference-in-difference	3	9%
	Regime-switching / volatility model	3	9%
	Total	32	100%
ESG proxy	ESG score / rating / performance	24	75%
	ESG index / taxonomy / sustainable portfolio	4	13%
	Environmental-specific proxy / carbon / biodiversity	3	9%
	ESG discourse / sustainability communication	1	3%
	Total	32	100%
Outcome variable	Stock return / stock performance	16	50%
	Abnormal return / CAR / alpha	8	25%
	Volatility / downside risk / risk-return measure	8	25%
	Total	32	100%
Direction of finding	Positive effect	12	38%
	Negative effect	6	19%
	Insignificant effect	4	13%
	Mixed / context-dependent effect	10	31%
	Total	32	100%

As shown in Table 1, the included studies are dominated by quantitative empirical approaches, particularly panel regression, event study, portfolio analysis, difference-in-differences, and volatility-based models. Event studies are commonly used to capture short-term market reactions, while panel regression is generally applied to examine longer-term ESG–stock return relationships (Mukanjari, 2020; El Khoury, 2021; Chen, 2022). The studies also vary in ESG measurement, including ESG scores, ESG ratings, ESG disclosure, ESG dimensions, carbon intensity, and sector-specific sustainability actions. This variation, together with differences in outcome measures such as stock returns, abnormal returns, excess returns, volatility, and downside risk, contributes to the heterogeneity of findings across studies (Demir, 2021; Williams, 2022).

Methodological Quality and Risk of Bias

The methodological quality of the included studies was assessed using the Mixed Methods Appraisal Tool (MMAT) 2018, which is appropriate for evaluating empirical studies with diverse methodological designs (Hong et al., 2018). Overall, most of the reviewed studies demonstrated moderate to high methodological quality, particularly those employing robust quantitative designs such as panel regression, event study, difference-in-differences, regime-switching models, and risk-return

analysis. These methods are generally appropriate for examining the ESG–stock return relationship because they allow researchers to capture both short-term market reactions and longer-term return dynamics (Campbell et al., 2020; Snyder, 2019).

However, several methodological limitations were identified across the included studies. First, potential endogeneity remains an important concern, as it is difficult to determine whether ESG performance drives stock returns or whether firms with stronger financial performance are more capable of investing in ESG initiatives (Cho, 2023; Naseer et al., 2025). Second, inconsistencies in ESG measurement across data providers may affect comparability, since ESG scores, ESG ratings, ESG disclosure, and ESG dimensions are not always measured using the same criteria (Anselmi & Petrella, 2025; Williams, 2022). Third, some studies rely on short observation periods, crisis-specific samples, or sector-specific settings, which may limit the generalizability of their findings (Chen et al., 2022; Demir & Danisman, 2021; Trisnowati et al., 2022).

Therefore, although the overall methodological quality of the evidence is acceptable for synthesis, the findings should be interpreted cautiously. The mixed results across studies may not only reflect differences in ESG effects, but also differences in research design, sample characteristics, ESG proxies, outcome variables, and market contexts (Demir & Danisman, 2021; El Khoury et al., 2021; Moolkham, 2025). These considerations support the use of narrative synthesis and vote-counting rather than quantitative meta-analysis in this review, particularly because of heterogeneity across study designs, markets, ESG proxies, and outcome measures (Campbell et al., 2020; McKenzie & Brennan, 2019).

Synthesis of ESG–Stock Return Findings

The synthesis of the 32 studies indicates that the relationship between ESG performance and stock returns is heterogeneous and context-dependent. The findings can be grouped into four broad categories: positive, negative, insignificant, and mixed effects. Several studies find that ESG performance improves stock resilience, reduces downside risk, or supports better stock performance, particularly during periods of market stress (Xu, 2023; Chen, 2022; Lööf, 2022). However, other studies find insignificant or even negative effects, suggesting that ESG does not always translate into superior market performance (Samaniego, 2022; Trisnowati, 2022; Williams, 2022).

Table 2. Synthesis Matrix of ESG–Stock Return Findings

Finding Direction	Interpretation	Number of Studies	Percentage	Main Pattern
Positive effect	ESG improves stock returns, abnormal returns, resilience, or downside protection	12	38%	Mostly observed during crisis periods, high uncertainty, or in firms with stronger ESG credibility
Negative effect	ESG is associated with lower stock returns or weaker market performance	6	19%	Often linked to ESG implementation costs, lower risk premium, or short-term adjustment effects
Insignificant effect	ESG has no statistically meaningful relationship with stock returns	4	13%	Common in markets where ESG information may not yet be fully priced by investors
Mixed / context-dependent effect	ESG effects vary across market conditions, firm size, sector, ESG dimension, or methodology	10	31%	Indicates that the ESG–stock return relationship is conditional rather than universal
Total		32	100%	

As shown in Table 2, the reviewed studies show heterogeneous findings, confirming that the ESG–stock return relationship is conditional rather than universal.

A consistent pattern emerges when market conditions are considered. ESG appears to be more valuable during periods of crisis, uncertainty, or high market volatility. During the COVID-19 pandemic, firms with stronger ESG performance were often found to exhibit greater resilience, lower volatility, and stronger downside protection (Xu, 2023; Chen, 2022). Similar evidence suggests that ESG may function more as a risk-mitigation mechanism than as a consistent generator of abnormal returns (Löf, 2022; Mukanjari, 2020). This means that ESG may become more relevant when investors are more concerned about risk, governance quality, reputation, and long-term sustainability.

In contrast, during stable or bullish market conditions, ESG effects tend to be weaker, insignificant, or mixed. Some studies suggest that investors may prioritize traditional financial indicators, such as profitability, valuation, growth prospects, and liquidity, when uncertainty is low (Williams, 2022; Trisnowati, 2022). In certain cases, ESG initiatives may also be perceived as costly or inefficient if investors do not believe that such initiatives generate immediate financial benefits (Samaniego, 2022). Therefore, ESG should not be understood as a universal return enhancer, but rather as a conditional factor whose value depends on the market environment.

Firm characteristics also play an important role in explaining the variation in findings. Larger firms tend to benefit more from ESG performance because they have greater visibility, stronger institutional investor coverage, and more established disclosure practices (Cho, 2023). Industry exposure also matters, as ESG effects tend to be stronger in sectors where environmental, social, or governance risks are more material, such as energy, oil and gas, transportation, banking, hospitality, and automotive industries (Demir, 2021; El Khoury, 2021; Samaniego, 2022; Chen, 2022). This suggests that ESG is more likely to be priced by investors when sustainability risks are directly linked to business operations and future cash flows.

Discussion of Main Findings

The findings of this review answer the research question by showing that ESG performance influences stock returns, but the relationship is conditional rather than uniform. ESG can contribute to better stock performance under specific conditions, especially during market downturns or periods of uncertainty. However, ESG does not consistently produce superior returns across all markets, sectors, and firms. This supports the view that ESG should be interpreted as a context-dependent financial factor rather than a standalone driver of stock returns.

Theoretically, the findings are consistent with stakeholder theory, signaling theory, agency theory, and the risk-management perspective. Stakeholder theory explains that firms with stronger ESG practices may develop better relationships with stakeholders, which can reduce operational and reputational risks. Signaling theory suggests that ESG disclosure and ESG ratings may serve as signals of firm quality, particularly in uncertain market environments (Cho, 2023; Demir, 2021). Meanwhile, the risk-management perspective provides the strongest explanation for the reviewed evidence, as many studies indicate that ESG contributes more clearly to downside protection, volatility reduction, and stock resilience than to persistent excess return generation (Lööf, 2022; Xu, 2023; Chen, 2022). The mixed findings also highlight the limitations of aggregate ESG scores. ESG scores may combine different dimensions that do not necessarily have the same financial implications. Environmental performance, social responsibility, and governance quality may influence stock returns through different mechanisms and may be valued differently across industries and markets (Demir, 2021; Mukanjari, 2020; El Khoury, 2021). Therefore, future studies should examine ESG dimensions separately and consider whether each dimension is financially material in a specific industry or market context.

Another important finding is that methodological design influences the reported relationship between ESG and stock returns. Event studies are more likely to capture short-term market reactions, particularly during crisis periods or ESG-related events. Panel regression studies, in contrast, tend to reveal more complex or mixed long-term relationships due to the influence of firm fundamentals, market characteristics, and potential endogeneity (El Khoury, 2021; Cho, 2023). This implies that inconsistencies in prior studies are not merely caused by conflicting evidence, but also by differences in research design, measurement, time horizon, and sample characteristics.

Theoretical and Practical Implications

Theoretically, this review contributes to the ESG and finance literature by clarifying that the ESG–stock return relationship is not linear or universal. The findings suggest that existing theories should be interpreted conditionally. Stakeholder theory and signaling theory remain relevant, but their explanatory power depends on whether ESG information is credible, material, and valued by investors. In this sense, the findings support a more nuanced view that ESG affects stock returns through risk reduction, investor perception, and resilience rather than through direct and guaranteed return enhancement.

Practically, the findings provide important implications for investors, portfolio managers, and policymakers. Investors should not treat ESG as a simple screening tool that automatically produces superior returns. Instead, ESG should be integrated with traditional financial analysis, including profitability, valuation, leverage, liquidity, sector exposure, and macroeconomic conditions. ESG appears particularly useful for managing downside risk and improving portfolio resilience during periods of uncertainty, but its effectiveness depends on market conditions and firm-specific characteristics.

For firms, the results imply that ESG initiatives should be aligned with business strategy and industry materiality. ESG practices are more likely to be valued by investors when they are credible, measurable, and directly connected to financial risks or long-term competitiveness. For policymakers and regulators, the findings highlight the need for more consistent ESG disclosure standards to reduce information asymmetry and improve the comparability of ESG information across firms and markets. Overall, the review suggests that ESG should be viewed as a strategic complement to financial analysis, not as a replacement for it.

CONCLUSION

The findings of this systematic literature review indicate that ESG performance has become an increasingly important consideration in financial markets; however, its impact on stock returns remains heterogeneous and context-dependent. While several studies show that ESG can improve stock resilience, reduce downside risk, and stabilize stock performance during periods of market stress, particularly during the COVID-19 pandemic, the evidence does not consistently support the view that ESG directly generates superior stock returns across all market conditions (Xu, 2023; Chen, 2022; Löff, 2022). This suggests that ESG is more appropriately understood as a conditional financial factor rather than a universal source of abnormal return.

In stable or bullish market conditions, the influence of ESG on stock returns tends to be weaker, insignificant, or mixed, suggesting that investors may prioritize traditional financial indicators over sustainability considerations when uncertainty is low (Williams, 2022; Trisnowati, 2022; Cho, 2023). Moreover, the effectiveness of ESG is strongly influenced by firm-specific characteristics, including firm size, industry exposure, and financial fundamentals, with ESG effects appearing more pronounced in large firms and sectors with high environmental or social exposure (El Khoury, 2021; Demir, 2021; Samaniego, 2022). Therefore, the relationship between ESG and stock returns should be interpreted through a contextual lens that considers both market conditions and firm-level heterogeneity.

These findings provide several practical implications. For investors and portfolio managers, ESG should not be interpreted as a standalone driver of excess returns, but rather as a complementary factor that enhances risk management, investor confidence, and long-term portfolio resilience. This interpretation is consistent with evidence suggesting that ESG contributes more strongly to downside protection and resilience than to persistent abnormal returns (Löff, 2022; Mukanjari, 2020; Chen, 2022). Accordingly, ESG integration should be combined with traditional financial analysis, including profitability, valuation, leverage, liquidity, sector exposure, and macroeconomic conditions.

For firms, the findings imply that ESG initiatives need to be credible, measurable, and aligned with business strategy. ESG practices are more likely to be valued by investors when they are connected to financially material risks, particularly in sectors with high environmental or social exposure (El Khoury, 2021; Demir, 2021). For policymakers and regulators, the review highlights the importance of improving ESG disclosure consistency and comparability so that investors can better assess the financial relevance of ESG information across firms and markets (Williams, 2022; Demir, 2021).

However, several limitations remain in the existing literature and in this review. Differences in ESG measurement, the prevalence of short-term crisis-based studies, limited sectoral and geographical comparability, and potential endogeneity issues limit the ability to draw definitive conclusions regarding the causal relationship between ESG and stock returns (Williams, 2022; Cho, 2023; Demir, 2021). In addition, this review is limited to studies indexed in Scopus and published between 2016 and 2026, which may exclude relevant studies from other databases or earlier periods.

Future research should employ longitudinal data, disaggregate ESG into environmental, social, and governance dimensions, and integrate market conditions and firm characteristics within more robust empirical frameworks. Further studies should also address endogeneity concerns using stronger econometric approaches, such as difference-in-differences, instrumental variables, or dynamic panel models, to better identify causal mechanisms. Overall, ESG should be viewed not as a replacement for traditional financial analysis, but as a strategic complement that enhances investment decision-making, particularly in managing downside risks and navigating uncertain market environments (Xu, 2023; Löff, 2022; El Khoury, 2021).

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