BALLOTPEDIA

ENVIRONMENTAL, SOCIAL, AND CORPORATE GOVERNANCE (ESG)

UNDERSTANDING THE BACKGROUND AND ARGUMENTS AROUND ESG

April 2025

BALLOTPEDIA
The Encyclopedia of American Politics

Environmental, Social, and Corporate Governance (ESG)

Understanding the background and arguments around ESG

Summary

This Learning Journey will explain what ESG is, provide background, and examine why it matters to policy discussions.

Table of contents: Page:

Ballotpedia's policy content and assets are a gateway to learning about policy and an unparalleled resource for in-depth, historical, clear, comprehensive, factual and neutral information on key policy areas.

ESG: What is it, and why does it matter?

Defining ESG

ESG is an investment approach that takes **environmental**, **social**, and corporate **governance** factors into account. It's a form of stakeholder investing, which argues shareholder returns should not be the only goal. Stakeholder investing contrasts with traditional approaches that exclusively consider financial factors like balance sheets, income statements, and valuations to maximize investment returns (also known as shareholder investing).

ESG investing varies in practice, but supporters commonly consider the following types of factors:

- **Environmental** factors include corporate energy consumption, carbon emissions, climate-related risks, deforestation, and waste management.
- **Social** factors include human rights issues, equality in hiring, labor relations, community activity, and diversity, equity, and inclusion (DEI) initiatives.
- **Governance** factors include board diversity, executive compensation, corporate ownership structures, and transparency in tax practices.

Why does it matter?

ESG investing is central to ongoing debates about the goals of public investment—especially in areas like pension fund management. Should financial managers consider only financial performance? Or should they also weigh social and environmental impacts?

These debates also influence:

- Policies governing how governments award contracts.
- Rules about what non-financial factors companies are required (or forbidden) to consider in their operations.
- The way ESG ratings and definitions are developed, regulated, or prohibited.

What's the background?

Academics like R. Edward Freeman argued in the 20th century that businesses should consider the interests of all stakeholders, not just shareholders, laying the theoretical foundation for ESG. The concept gained momentum in the early 2000s when the United Nations began promoting ESG investment approaches and facilitating initiatives between financial institutions, including the Principles for Responsible Investment.

Key ESG terms

Now we examine the most important terms surrounding ESG pubic policy conversations so you're ready to jump in!

Asset management company

An asset management company (AMC) is a firm that invests and manages funds on behalf of clients. Most AMCs operate as fiduciaries—meaning that they are legally required to make investment decisions in the best interest of their clients. AMCs may also be responsible for proxy voting on behalf of shareholder clients. In the context of public policy, states often hire AMCs to manage their public pension investments, raising questions about whether AMCs should be allowed to consider ESG criteria in their management of public money.

Fiduciary duty

The term fiduciary duty refers to the legal obligation of a fiduciary to act in another person's best interest. Financial advisors, trustees, lawyers, and other types of professionals are examples of fiduciaries with certain obligations to their clients. In the context of public policy, states typically hire fiduciaries such as AMCs to manage public funds, including public pension investments. One important topic of discussion concerns whether definitions of fiduciary duties should prohibit asset managers from considering non-financial factors like ESG criteria in their investment decisions.

Materiality

Materiality refers to the importance of information in influencing the decisions of investors. If a piece of information could affect how someone evaluates a company's financial health, performance, or riskiness, it's considered material. In the context of ESG, supporters argue that environmental, social, and other non-financial factors are important (material) in making good investment decisions. Opponents argue that the only material factors relevant to investment decisions are those that directly impact financial performance and returns (not social, environmental, or political considerations).

Proxy voting

Proxy voting refers to the process through which shareholders who do not physically attend corporate shareholder meetings vote on company issues such as executive pay packages, board membership, and other shareholder and management proposals. Typically, proxy voting occurs over the phone, by mail, or online. In the context of public policy, discussions of proxy voting center on the question of how public pension boards should vote their proxies on behalf of plan beneficiaries and how governments should instruct their fiduciaries to vote public proxies. Should they favor ESG criteria or focus exclusively on financial considerations?

Key ESG terms (continued)

Shareholder model of the corporation

The shareholder model of the corporation is a theory of corporate governance that argues the people who own shares of a corporation's stocks (shareholders) should own and manage the corporation to maximize financial returns on their investments. It contrasts with the stakeholder model of the corporation.

Stakeholder model of the corporation

The stakeholder model of the corporation is a theory of corporate governance that argues firms should serve the wider interests of stakeholders rather than those of shareholders only. The stakeholders in this model generally include shareholders, employees, creditors, suppliers, customers, and the local community.

Arguments about ESG

Here we present some of the major debates related to the topic. For a comprehensive list of arguments, click here.

Arguments about investment outcomes

- **ESG enhances investment outcomes:** Supporters argue ESG considerations can produce stronger long-term returns by accounting for climate risks and regulatory trends. They say ESG investing aligns with market trends and helps investors avoid companies with unsustainable practices.
- **ESG hurts investment outcomes:** Opponents argue ESG investments tend to underperform compared to traditional strategies, limit diversification by excluding certain industries, and introduce inefficiencies that raise risk without delivering better financial returns.

Arguments about core business functions

- **ESG improves core business functions:** Supporters argue ESG practices enhance business performance by increasing employee satisfaction, reducing risk exposure, improving compliance, and strengthening brand loyalty. They say ESG factors drive innovation and support sustainable profitability.
- **ESG harms core business functions:** Opponents argue ESG distracts from core business priorities like customer needs and profit maximization. They say it introduces confusion and internal conflict, weakens management's focus, and shifts attention away from shareholders' interests.

Arguments about economic and political structures

- **ESG brings more voices into decision-making:** Supporters say ESG frameworks democratize corporate governance and consider workers, local communities, and other stakeholders. This broader input, they argue, leads to more ethical, balanced, and sustainable decision-making.
- **ESG turns companies into undemocratic political instruments:** Opponents argue ESG injects ideological agendas into business operations, allowing unelected corporate leaders and asset managers to advance political goals without public accountability, undermining democratic norms.

Arguments about environmental impacts

- **ESG is good for the environment:** Supporters argue ESG drives companies to reduce carbon emissions, invest in cleaner technologies, and adopt sustainable practices throughout their supply chains. They say this helps the environment over time.
- **ESG does not help the environment:** Opponents argue ESG is a public relations tactic and doesn't drive meaningful environmental change. They say such tactics mislead regulators and customers and delay environmental policy reforms.

Arguments about ESG (continued)

Arguments about social impacts

- **ESG commitments help society:** Supporters argue ESG encourages companies to address social challenges—like inequality, health, and justice—and align business interests with the public good. They say this strengthens communities and promotes long-term prosperity.
- **ESG causes social harm:** Opponents argue that ESG can have unintended negative consequences and promotes investments in non-American companies (including those with ties to forced labor). They say global agendas drive ESG and undermine human rights and social stability.

Continued reading on ESG:

- Environmental, social, and corporate governance (ESG)
- R. Edward Freeman
- Stakeholder investing
- Shareholder investing
- State public pension plans
- Asset management company
- Fiduciary duty
- Materiality (ESG)
- Proxy voting
- Stakeholder model of the corporation (stakeholder capitalism)
- Shareholder model of the corporation
- Arguments about ESG

Writers

Ballotpedia Policy Team
Michael Leland, Managing Editor, Policy
Jimmy McAllister, Senior Policy Staff Writer
Jon Dunn, Policy Staff Writer
Amy Handlin, Policy Staff Writer
Annelise Reinwald, Policy Staff Writer
Emma Soukup, Policy Staff Writer
Mina Vogel, Policy Staff Writer

About Ballotpedia:

Ballotpedia is the digital encyclopedia of American politics, and the nation's premier resource for unbiased information on elections, politics, and policy.

We provide our readers curated content on all levels of U.S. politics that is relevant, reliable, and available for all. Ballotpedia's policy content and assets are a gateway to learning about public policy and an unparalleled resource for in-depth, historical, clear, comprehensive and factual information on key policy areas. We are firmly committed to neutrality in all our content.

Ballotpedia is a 501(c)3 charitable nonprofit organization and is not affiliated with any campaigns or candidates for office. All gifts to Ballotpedia are tax deductible to the extent of the law and help to provide voters with information about their ballots.

BALLOTPEDIA
The Encyclopedia of American Politics