

## **Rational Sustainability\***

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### **Abstract**

ESG is under attack from all sides. True believers wish to keep practicing ESG but call it something different; opportunists recognize that an ESG label no longer helps launch funds or attract customers; opponents seek to ban ESG outright. But if ESG is to be scrapped, what do we replace it with? Retiring the term but continuing the practice fails to address the legitimate challenges to ESG; abandoning the practice throws the baby out with the bathwater. This article proposes an alternative: “Rational Sustainability”. It seeks sustainability – the creation of long-term value – which is of interest to all job titles and political leanings; it does not limit the value creation tools to those with an ESG label. It is rational since it recognizes diminishing returns and trade-offs; it is based on evidence and analysis; and guards against irrational sustainability bubbles.

**Keywords:** ESG, SRI, CSR, sustainable investing, responsible business

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\* I thank Russell Chaplin and Chris Miller-Jones of Europa Capital for a discussion that sparked the term “rational sustainability.”

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## 1. Introduction

ESG is under attack from all sides. Opponents object to the consideration of environmental, social, and governance (“ESG”) issues in investment decisions, arguing that it allows fund managers to pursue their own agendas at the expense of their clients’ returns. Proposed solutions range from disinvesting from ESG funds to banning ESG outright. In January 2024, Republican lawmakers in New Hampshire introduced a bill to prohibit the state from investing in funds that consider ESG factors; violation would be a felony punishable by up to 20 years in prison.

Supporters range from true believers, who genuinely view ESG as a way to achieve both financial returns and social impact, to opportunists who saw ESG – at least historically – as a means to exploit a bubble. Asset managers launched ESG funds; companies courted capital, customers, and colleagues by touting their ESG credentials; and authors, influencers, and professors reinvented themselves as ESG experts even if they never previously cared for the topic. But both true believers and opportunists are recognizing the shifting sands – the former are ploughing ahead but calling it something different; the latter are reversing course and looking for the next fad. In June 2023, BlackRock’s Larry Fink, a previously outspoken ESG supporter, announced that he’d no longer use the ESG term because it had become “weaponized”, but not change his actual stance. A January 2024 *Financial Times* article noted that just six funds citing ESG factors launched in the second half of 2023, compared with 55 in the first half<sup>1</sup>; on the same day, the *Wall Street Journal* dubbed ESG “the latest dirty word in Corporate America”.<sup>2</sup>

Alongside the true believers and opportunists lies a third group of supporter. They believe that the *practice* of integrating some, but not all, ESG factors, can create value, but the *term* “ESG” has several problems. Edmans (2023a) argued that ESG is “extremely important” because it is critical to long-

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<sup>1</sup> *Financial Times* (2024): “Launches of ESG funds plummet as investors pull back.” January 9, 2024.

<sup>2</sup> *Wall Street Journal* (2024): “The latest dirty word in corporate America: ESG.” January 9, 2024.

term value and thus should be of interest to anyone, but the term “ESG” implies that it’s niche; and “nothing special” compared to other intangible assets such as productivity, innovation, and culture, but the term “ESG” puts it on a pedestal. This is far more than a semantic issue as the term affects the practice – Republicans may have an allergic reaction to funds labelled “ESG” even if they use it for financial goals, and Democrats may pile into such funds irrespective of their actual performance. While Edmans (2023a) was entitled “The End of ESG” and advocated for the *practice* to become both more mainstream and more nuanced, Edmans (2023b) argued that the *term* should be scrapped. And Edmans (2023c) highlighted a third problem: the term “ESG” sometimes replaces clear-headed thinking by implying that it is different from mainstream business. As a result, we think that the insights from decades of research do not apply and resort to “gut feel” when practicing ESG.

But if we scrap ESG, what do we replace it with? Retiring the term without changing the practice fails to address the many legitimate concerns about ESG. Abandoning the practice entirely will throw the baby out of the bathwater, and lose the many benefits of considering ESG factors in corporate and investment decisions. In “The End of ESG” I suggested that we replace the term with either “long-term value” or “intangible assets”, but neither term is perfect. ESG supporters argue that, even though in theory “long-term value” should lead us to consider any relevant factor, including ESG, in practice we may not, and “ESG” usefully reminds us to do so. “Intangible assets” does direct us to go beyond tangible factors, but isn’t catchy enough, which is why I’m a finance rather than marketing professor – people won’t say “I work in intangible assets” or “I do intangible assets investing”. A separate issue is that practitioners typically consider intangible assets only for financial reasons, but ESG may be pursued for social objectives.

This article proposes the term and practice of “Rational Sustainability” as an alternative to ESG. It involves “sustainability” as its goal is sustainable, long-term value, which is relevant to all job

functions and political beliefs. It considers all factors that create value, regardless of whether they fall under an ESG label, and deprioritizes immaterial factors even if they can be called ESG. It is “rational” in that it recognizes diminishing returns and trade-offs. It is based on evidence and analysis; it questions sustainability rather than following the herd; and it guards against being caught up in irrational sustainability bubbles.<sup>3</sup>

Rational Sustainability has ten features, the first five focusing on “sustainability” and the second five on “rational”:

1. Rational Sustainability is About Value Creation, not Politics.
2. Rational Sustainability is About Outcomes, not Labels.
3. Rational Sustainability is Intrinsic, not Instrumental.
4. Rational Sustainability is Core, not Peripheral.
5. Rational Sustainability is Enabling, not Prescriptive.
6. Rational Sustainability Builds on Evidence and Analysis.
7. Rational Sustainability Recognizes Diminishing Returns and Trade-Offs.
8. Rational Sustainability Sets Boundaries.
9. Rational Sustainability Guards Against Irrationality.
10. Rational Sustainability Challenges and Questions.

I now go through these ten features in turn.

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<sup>3</sup> Over time, the term “rational” will hopefully not be needed; even now, I am not advocating for “Rational Sustainability” to be in a job title or fund name. Instead, the term “rational” is to stress the importance of approaching sustainability in a rational way and guard against the irrationalities in current practice. By analogy, “enlightened shareholder value” highlighted the need to invest in stakeholders to pursue shareholder value, even though it would be an overreach for someone to call themselves “enlightened” for doing this.

## 2. Rational Sustainability

### 2.1 Rational Sustainability is About Value Creation, not Politics

The goal of Rational Sustainability is to create sustainable – that is, long-term – value. Creating sustainable profits, companies, economies, and societies should be of interest to everyone, irrespective of their job title, their political persuasion, or their age. In contrast, ESG is seen as being of interest only to ESG executives, those on the left, and the young. It is surprising that some Republicans wish to ban ESG on the grounds that they are the party of big business, when considering environmental, social and governance factors can help companies become more successful, more profitable, and more innovative.

In Edmans (2023c), I argued that the term “ESG” has become so politicized that it prevents clear-headed thinking; as a result, we sometimes need to remove it and evaluate the remaining sentence in order to make logical assessments. Some critics argue that considering ESG risks is inconsistent with fiduciary duty, but this is illogical since considering risks is an essential part of fiduciary duty. Such politicization is unlikely to be the case with sustainability, because “sustainable” simply means “long-term”. Lawmakers are unlikely to seek to punish the consideration of sustainability risks with 20 years in prison, and are even less likely to ban the consideration of long-term risks or rationality.

In my book *Grow the Pie* (Edmans, 2020), I argued that the term “sustainable” is so uncontroversial that it is somewhat bland; it’s obvious that a company should be sustainable. I wrote that “a stakeholder-focused company is often described as ‘sustainable’, but ‘sustainable’ simply means ‘long-term’. ESV [Enlightened Shareholder Value, the pursuit of purely financial goals] could be called ‘sustainable’ as it also takes a long-term approach, albeit to maximize profits rather than social value. We’ll thus not use ‘sustainable’ in this book.” But that was before the politicization of ESG and I’ve had to update my view. Advocates and critics have become so caught up in cheerleading

and criticizing ESG, or scoring points against the other side, that they've lost sight of the shared goal – to create long-term value. Today's environment calls for a bland term that goes back to basics.

## **2.2 Rational Sustainability is About Outcomes, not Labels**

The current practice of ESG gives special status to something just because it can be called ESG. ESG funds attract inflows even if not justified by performance; business schools boost their league table ranking by reporting more hours of ESG teaching; some investors, employees and customers put more weight on a company's ESG claims than delivering great returns, being a great place to work, or offering great products.

Certain ESG advocates argue that the label should be expanded so that more activities can get credit. Some enlarge it to "EESG", with an extra E for Employees as they are too important to be considered a subset of S;<sup>4</sup> others argue that any extra E should stand for Equity.<sup>5</sup> When I was a panelist at an ESG conference, an audience member questioned why we were using such an outdated term and advocated BESG given the importance of biodiversity. Companies may end up in an arms' race to add letters and move to BEEESG, just as some organizations focused more on expanding LGBT to LGBTQIA2S+ rather than actually being inclusive.

Such labelling can mask the lack of action. Pastor, Stambaugh, and Taylor (2024) note that, despite the supposed surge of ESG investing, ESG-related portfolio tilts represented only 6% of the investment industry's total assets in 2021. Cooper, Gulen, and Rau (2005) found that, when a mutual fund changes its name to reflect a current "hot" style, it enjoyed 28% extra inflows despite no improvement in performance and irrespective of whether its holdings match its new name.<sup>6</sup>

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<sup>4</sup> <https://www.responsiblebusiness2030.com/its-all-about-the-culture/what-do-we-mean-by-eesg-metrics/>

<sup>5</sup> <https://www.rsm.global/southafrica/insights/risk-advisory-insights/moving-esg-eesg>

<sup>6</sup> While the study is on investment styles in general, such as value and growth, the insights also likely apply to ESG. Hartzmark and Sussman (2019) found that higher fund sustainability ratings led to significantly higher fund inflows.

Rational Sustainability is concerned with outcomes, not labels. The goal of sustainability is to create long-term value; a fund that adds “ESG” to its name without changing its holdings is not investing more sustainably. A fund that adds ESG to its name *and* changes its holdings is also not investing more sustainably if those actions do not enhance long-term returns.<sup>7</sup>

Rational Sustainability also both widens and focuses our perspective. It widens our perspective as it stresses the need to consider any factor that creates sustainable value, even if it does not fall under an ESG label – such as productivity, innovation and culture. It focuses our perspective as it cautions against pursuing a factor simply because it falls under the ESG umbrella, if it does not create sustainable value. Yet Rational Sustainability may be superior than “long-term value”, as the inclusion of “sustainability” highlights the need to consider societal factors that may have otherwise been overlooked.

### **2.3 Rational Sustainability is Intrinsic, not Instrumental**

Why is there such a focus on labels? One reason is that there are instrumental benefits from being called ESG – funds enjoy inflows and companies attract customers. What matters is not so much doing ESG but being seen to do so.

But companies should instead ask themselves: “If you couldn’t tell anyone you were doing it, would you still do it?” The answer might be “No” for many ESG initiatives, since their only benefit is instrumental. In contrast, a word that is often paired with “sustain” is “self” – we have self-sustaining organizations, ecosystems, populations, and organisms. Sustainability is pursued for intrinsic reasons – because it’s good for you. It allows organizations, ecosystems, populations, and organisms to thrive for decades, even centuries.

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<sup>7</sup> As discussed in Section 5, these may be financial or social returns.

An instrumental approach to ESG undermines one of its key rationales. In theory, there should be no need for the ESG acronym to have ever been coined. Executives should know to invest in anything – including ESG – that ultimately creates long-term value, just as they’d improve a company’s productivity, innovation, and culture even though there’s no PIC acronym. However, one rationale for ESG is that the financial benefits of ESG (unlike PIC) are hard to predict, no matter how long-term an executive thinks. An explicit ESG objective can encourage an executive to make an investment because of its ESG benefits, and those benefits ultimately manifest in financial returns – however, because these returns were difficult to forecast, they alone wouldn’t have justified the investment (Edmans, 2020). For example, Vodafone launched the mobile money service M-Pesa in 2007 for the social return of improving financial inclusion in Kenya, but was later able to turn this into a financial return by charging a small percentage of every transaction.

If instead ESG is pursued for instrumental reasons, this narrows the freedom that ESG provides. M-Pesa does not improve any of the common ESG metrics that companies are scored on, such as carbon emissions, water usage, CEO-to-pay ratio, or gender diversity. It would have never been sanctioned under an instrumental approach to ESG. Sustainability frees a company to create long-term value, irrespective of whether it will get a gold star from doing so.

#### **2.4 Rational Sustainability is Core, not Peripheral**

Generating long-term, sustainable value is widely accepted as being a core – arguably the core – function of business. Finance 101 teaches you that shareholder value is the present value of *all future* cash flows; any business decision should be evaluated by its long-term consequences. Sustainability is thus the responsibility of every executive within a company, irrespective of your job title.

In contrast, ESG is often viewed as a peripheral cost center. In some asset management firms, the investment team focuses on forecasting long-term cash flows; ESG is a side analysis done by a



separate team so that they can tell clients they are “doing ESG”. They then hire “ESG integration” specialists to force fund managers to have at least a cursory glance at the ESG analysis rather than reaching for the bin. Sustainability recognizes the criticality of analyzing a company’s impact on society, because many of those impacts will ultimately feed back and affect its profits. The analysis may still be conducted by a separate department given its specialist nature, and there may still be integration professionals given the expertise required, but such analyses are eagerly welcomed and would still be even if you couldn’t tell your clients.

A word often used interchangeably with “sustainability” and “ESG” is “purpose”, which I advocated in Edmans (2020). I continue to strongly believe in the power of purpose to generate financial and social value. However, at least as commonly practiced, “purpose” has been reduced to a slogan; the branding team comes up with a snappy-sounding purpose but it has no effect on a company’s decisions. Fund manager Terry Smith famously criticized Unilever for coming up with a “purpose” for mayonnaise when it is nothing more highbrow than salads and sandwiches. Ben & Jerry’s claims that “we believe that ice cream can change the world” but it is unclear whether executives truly believe this and, if they did, how it would affect any corporate decision. Then, purpose has no purpose.

## **2.5 Rational Sustainability is Enabling, not Prescriptive**

I’ve referred to the goal of sustainability as “long-term value”, but been vague about what this value is. Is it purely financial value, or does it include social value? And if it does, which societal objectives, and how much financial value should you be willing to sacrifice for them?

In “The End of ESG”, I argued that ESG investing is often just investing, because an investor should consider all factors relevant for generating long-term returns – ESG criteria are no better or worse than the others. However, I acknowledged that one way in which ESG investing is *not* investing

is that investors may use them for non-financial objectives. Rational Sustainability allows for such non-financial goals – the value that it creates can be both financial and social – but it differs from ESG in two important ways.

First, any societal objectives are pursued in a sustainable way. Targeting diversity, equity, and inclusion (DEI) by hiring minorities irrespective of their ability may improve a company’s short-term DEI statistics, but backfire in the long term as those hires don’t succeed and leave. The company itself suffers worse performance, hindering its ability to hire in the future.

Second, Rational Sustainability emphasizes the need to be explicit about any non-financial objectives. To achieve long-term goals, you need to state what those goals are. Internally, it clarifies what employees should aim for; externally, it brings transparency and allows customers to go somewhere else if they’re not aligned. A fund may choose to sacrifice a small amount of financial returns to address climate change, but it needs to make this sacrifice clear in its prospectus rather than claiming that everything’s a win-win. Otherwise, if the fund ends up underperforming, clients may withdraw their money as they were promised outperformance.

## **2.6 Rational Sustainability Builds on Evidence and Analysis**

The next five principles highlight the key features of “rational” sustainability. In theory, there should be no need for such emphasis because people should always act rationally – just as in theory there should be no need to emphasize sustainability since people should always think long-term. However, there is widespread evidence of irrationality in many other contexts (see Ariely (2008) and Kahneman (2011) for popular summaries), and irrationality is likely even more severe for sustainability given confirmation bias. Sustainability advocates may believe that sustainability is always beneficial; detractors may think it is always harmful.

One important example of irrationality is in the interpretation of data and evidence. A huge number of sustainability studies abound, often written by commercial organizations with limited research credentials and whose goal is a PR boost rather than the truth. They get it by claiming what people want to hear – that sustainability always improves performance. Often, these studies are lapped up uncritically by readers who like the findings even if the analysis is weak. In Edmans (2024), I highlight the numerous ways in which people fall for fluff: headlines are written about a study that does not exist; a study exists but doesn't conduct any analysis; the authors claim the opposite of what the analysis finds; the analysis doesn't actually measure sustainability or performance; the authors conducted dozens of analyses and only reported the ones that work; and the authors trumpet causation when there is only a correlation. These errors appear so basic that it seems incredulous that anyone would fall for them – how could you believe a claim when the results show the opposite? – but rationality goes out of the window when confirmation bias is at play. In contrast, studies uncovering inconvenient truths are dismissed out of hand, as “one study out of many” or as being politically motivated.

A rational look at the data finds that the evidence is much more nuanced than either side commonly claims. Some ESG factors are associated with higher long-term financial returns, such as corporate governance (Gompers, Ishii, and Metrick, 2003), employee satisfaction (Edmans, 2011, 2012; Boustanifar and Kang, 2022), and customer satisfaction (Fornell et al., 2006, 2016)). However, even those results may not be universal: corporate governance is uncorrelated with returns in competitive industries (Giroud and Mueller, 2011), employee satisfaction does not lead to outperformance in countries with heavily regulated labor markets (Edmans et al., 2023) and ESG only generates high returns in crisis periods (Lins, Servaes, and Tamayo, 2017).

In contrast, some of the factors that ESG advocates are particularly passionate about may have no or a negative correlation with returns. Companies that emit more carbon enjoy *higher* returns (Bolton

and Kacperczyk, 2021) and these higher returns arise from outperformance, not risk (Atilgan et al., 2023); moreover, they are not robust to different methodologies (Aswani, Raghunandan and Rajgopal, 2024; Zhang, 2024). Multiple McKinsey studies claim that diversity is strongly correlated with company performance but they suffer from elementary flaws (Green and Hand, 2021); a review of the highest-quality academic evidence finds a zero or negative link between diversity and company performance (Fried, 2023).

Rather than being piqued by negative findings and wanting to ignore or attract them, a rational response is to use them to practice sustainability more effectively. Knowing that certain factors are not linked to financial performance allows you to focus on the ones that are. Alternatively, it may prompt you to go deeper and analyze more complex measures of sustainability than the ones featured in the study. The lack of a link between demographic diversity and performance need not imply that DEI has no value, but that demographic diversity is a blunt measure of DEI. Edmans, Flammer, and Glossner (2023) find that a holistic measure of DEI, which incorporates equity and inclusion, is positively linked to financial performance.

In addition to a careful approach to the data, Rational Sustainability involves a careful approach to analysis and logic. Sometimes, caution goes out of the window when considering ESG, viewing it as a magic word that defies the need to conduct analysis – for example, the belief that a fund should always boycott fossil fuels due to their ESG risks, and always invest in electric cars due to their ESG opportunities. Rational Sustainability involves treating ESG like any other factor. Just as a rational reader applies the same scrutiny to an ESG study as to any other study, a rational investor compares an ESG stock to its price just like any other stock. A company could be risky, but the risks could be more than discounted; it could be attractive but overpriced due to a bubble.

## **2.7 Rational Sustainability Recognizes Diminishing Returns and Trade-Offs**

In January 2024, I was discussing sustainable real estate with two investors, Russell Chaplin and Chris Miller-Jones of Europa Capital. They questioned whether a potential investment should always have more green building certifications than less; or, having bought a building, whether to follow the common industry trend of trying to get as many certifications as possible. They saw the value of sustainability but recognized the diminishing returns to each additional certification, as well as the increasing costs – both in renovating the building to qualify for certification and investing the time and money to get certified. I then described their approach as “Rational Sustainability”.

Irrational sustainability involves pursuing a project, investment, or certification just because it is viewed as sustainable. Even if it actually sustainable and has genuine benefits rather than just ticking a box, there will be costs to it – direct financial costs of making the investment, and indirect costs of time diverted from other value-creating activities. In addition, more is not always better; as with any investment, returns are diminishing and can turn negative. Rational Sustainability recognizes that sustainability factors are subject to the same laws of gravity as everything else. It encourages us to look at the big picture – rather than getting engrossed with the benefits, to step back and consider the costs.

## **2.8 Rational Sustainability Sets Boundaries**

Principle #7 highlighted that, if you consider a given ESG factor, more is not always better. This principle highlights that a greater number of ESG factors is not always better.

Irrational sustainability involves trying to tick as many ESG boxes as possible. The more you tick, the higher your ESG rating will be, and the less likely that customers will boycott you for failing to tick their preferred box. Rational Sustainability recognizes that, while a company has responsibilities to society (either for financial or social reasons), there are limits: Apple should not be culpable if its

excellence hastens the decline of BlackBerry, nor if its hiring standards prevent low-quality applicants from getting jobs (Edmans, 2023d). A company is not responsible for addressing all of society's challenges or pursuing all 17 Sustainable Development Goals. That's the role of governments.

Rational Sustainability sets boundaries. It establishes a framework for analyzing what a company's responsibilities should and should not be. This framework in turn guides decisions on how to allocate capital, headcount, and time. A company can then be held accountable for delivering on the responsibilities that it has set out. Without such boundaries, anything goes; it is not clear how an executive should navigate trade-offs, or what investors should hold her accountable for.

In Edmans (2020), I propose two criteria to establish such boundaries. One is *comparative advantage*: a company should focus on those sustainability activities in which it has unique expertise. Vodafone should invest in M-Pesa since it has telecoms expertise; it should not donate money to charity because it has no special ability to evaluate which charities are most worthy or effective. A second is *materiality*: a company should prioritize those stakeholders that are most important for its business model. Apple should invest in specialist suppliers such as Corning, which provides the touch-screen glass for its iPhones, but commodity suppliers are less material. Companies may choose their own criteria, but *some* criteria are needed otherwise decisions are arbitrary.

## **2.9 Rational Sustainability Guards Against Irrationality**

The irrationality that plagues sustainability is not limited to confirmation bias. Another behavioral bias that is particularly relevant for sustainability is herd mentality, where people pile into something because everyone else is doing so. Professors rush to teach courses on ESG irrespective of expertise, companies like Target, Bud Light and Disney raced to embrace liberal issues without thinking about their conservative customers, and investors jump on the latest DEI fad.

One example of the latter is the big market delusion that existed in electric vehicles (“EVs”) in early 2021 (Arnott, Cornell, and Wu, 2021).<sup>8</sup> Investors were so excited about the sustainability credentials of EVs – their potential to generate financial returns and address climate change – that they bid up the values of EV stocks to nonsensically high levels. Adding up the price of each EV company led to an implausible value for the total EV industry, even under the most optimistic scenario for the uptake of EVs. However, investors forgot this “adding-up constraint” in their mania.

A second irrationality is the “zero-risk bias”, where people prefer the complete elimination of a risk, even if its substantial reduction is sufficient. As an everyday example, consumers pay for overpriced extended warranties even if the risk of a breakdown is already small, to reduce it to zero.<sup>9</sup> In a sustainability context, many companies have signed up to be “net zero”, perhaps due to the attractiveness of “zero”. However, society can be net zero as a whole without every company being net zero. Some industries, such as reforestation, will naturally be carbon-negative; for other industries, such as construction, it is impossible to be net zero without the use of offsets, whose validity and effectiveness has been challenged (e.g. Gosling, 2023) and whose purchase is inconsistent with comparative advantage.

In addition to guarding against your own irrationality, Rational Sustainability allows investors to exploit market irrationality – selling sustainable companies that are overpriced, or buying sustainable companies that are underpriced because they do not tick ESG boxes. One might question whether it is responsible – sustainable, even – to exploit others’ irrationality. Launching funds with ESG labels to capitalize on people’s misbelief that ESG always pays off might be seen as irresponsible.<sup>10</sup> This is why I have referred to “market irrationality” rather than “consumer irrationality”. Participants in

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<sup>8</sup> Cornell and Damodaran (2020) introduced the term “big market delusion”, but applied it to dot com retail, online advertising, and cannabis rather than electric vehicles or sustainability.

<sup>9</sup> A related phenomenon is “probability weighting”, where people overweight the likelihood of very low probability events as long as that probability is greater than zero, such as winning the lottery.

<sup>10</sup> Alternatively, one might argue that it is responsible as it is catering to consumer demand; investors may get feel-good factors from investing in ESG funds which offset any financial loss.

financial markets, who choose to trade individual stocks when they could buy mutual funds, should know that they are swimming with sharks. Moreover, exploiting irrationality corrects mispricing, making market prices more accurate signals for corporate decision makers (Bond, Edmans, and Goldstein, 2012). For example, deflating the EV bubble will prevent EV companies from raising cheap equity when the industry is already over-capacity and needs a shake-out; buying underpriced sustainable companies will help the market recognize their value.

## **2.10 Rational Sustainability Challenges and Questions**

Principle #9 highlighted how the herd mentality can lead to market bubbles and crashes. It can similarly distort executives' decisions by leading to them taking actions indiscriminately, just because everybody else is doing it.

For example, many companies have signed up to net zero without even understanding what “net” or “zero” is. Starting with the former, it is not obvious whether it is appropriate to net off negative emissions, thus treating them as equal to emissions reduction. Moving to the latter, it is unclear how to define zero due to indirect positive effects (manufacturing semiconductors releases greenhouse gases, but semiconductors may be used in solar panels) and indirect negative effects (electric cars may use electricity from fossil fuels). Furthermore, it is not clear whether every company needs to net zero even if society should be, whether firms have calculated the financial cost of net zero (compared to, say, a 95% reduction in emissions), and whether “net benefit” (which includes environmental and social impacts beyond carbon) is a better target than “net zero”.

Principle #7 highlighted the importance of stepping back and looking at the big picture of a decision – its costs as well as its benefits. Challenging and questioning involves stepping back even further and looking at the big picture of the problem the decision is trying to solve. For example, the Financial Conduct Authority (2023), a UK regulator, proposed to regulate the diversity of a



company's workforce under the claim that their Consumer Duty is to ensure fair provision of financial services to customers. But if this is their goal, then the solution is to directly regulate fair provision of financial services to customers, not demographic diversity of employees which is very far removed (Edmans, 2023e). However, given frequent calls to regulate diversity from pressure groups, and the herd mentality of following regulators in other countries, a particular regulator may pounce on doing so without asking what problem it is a solution to, and whether a non-sustainability regulation would solve it more effectively.

### **3. Conclusion**

This article has proposed “Rational Sustainability” as an alternative to ESG – a term and practice that started off with much promise and good intentions, but has not achieved this promise due to true believers implementing it naively, ardent adversaries opposing it blindly, and opportunists exploiting it for self-interest.

Rational Sustainability is sustainable. Its goal is long-term sustainable value, not political objectives; it includes everything that improves long-term value irrespective of whether it is labelled ESG; it is pursued by companies even if they can't tell anyone they're doing so; it is embraced as a core profit center not resented as a peripheral cost center; and it accommodates different definitions of value. Rational Sustainability is also rational. It is based on evidence and clear-headed analysis; it recognizes diminishing returns and trade-offs; it sets boundaries rather than thinking that “anything goes”; it guards against your own irrationality and capitalizes on market irrationality; and it challenges and questions rather than following the herd.

Rational Sustainability has the potential to create long-term value for shareholders and society, fulfilling the promise that ESG failed to.

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