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Not Always ESG! Performance Feedback and ESG Performance

Abstract:

Research on performance feedback has primarily focussed on market activities that the firms would undertake in case of performance shortfall, potentially overlooking secondary or non-market activities. Very few studies have examined the relationship between performance feedback and ESG engagement. Borrowing from the behavioral theory of the firm and control theory, we claim and prove the differential effects of social and historical aspirations on ESG engagement. We further explore the role of the CSR committee in the relationship between performance feedback and ESG engagement. We carry out our study on a rich data set of U.S firms for the time period 2013-2022. Consistent with our assumptions, we obtained partial support for our hypothesis, which states that firms do not always engage in secondary or non-market activities whenever they experience negative performance feedback. We also find that a firm's behavior to engage in ESG activities varies with social and historical aspirations.

Keywords:

ESG, Aspirations, Performance shortfall, Control theory, CSR Committee

1. Introduction:

In the recent decade, strategy scholars have become increasingly interested in unveiling the effect of corporate social responsibility on a firm's financial performance as firms around the World are pressurized to meet the balanced expectations of the stakeholders and society by investing and developing the CSR activities (Aguilera et al., 2007; Barrena Martínez et al., 2016; Boulouta & Pitelis, 2014; Carroll & Shabana, 2010). The Environmental, Social, and Governance (ESG) score has transpired as a vital part of CSR to develop strategies that could influence corporate financial performance (CFP) (Eccles et al., 2013). Even after a decade of research, there remains a debate on the sign of the ESG-CFP relationship (K.-H. Lee et al., 2016; Lo & Sheu, 2007; McWilliams & Siegel, 2000a; Surroca et al., 2010; van Beurden & Gössling, 2008; Waddock & Graves, 1997). The first group of scholars found that investment in ESG improves corporate financial performance (Cahan et al., 2015; Lo & Sheu, 2007); the second group of scholars found negative effects (Branco & Rodrigues, 2008; D. D. Lee et al., 2009) and the third group of scholars found no relation between ESG and corporate financial performance (Galema et al., 2008; Orlitzky et al., 2003).

While there has been much research on the ESG-CFP relationship, empirical research on the relationship between a firm's performance and its ESG engagement has received little attention (Melo, 2012). This relationship is essential to understand as the decisions made by firms impact ESG performance, and these decisions differ as performance levels rise or fall below aspiration levels. When the performance levels fall below the aspiration levels, firms will undertake a problemistic search (Levinthal & March 1981; R. C. March James, 2006) and engage in strategic actions such as R&D investment (Chen & Miller, 2007) and organizational risk-taking (J. A. C. Baum et al., 2005). It is, therefore, essential to understand what good versus bad performance is that may influence the ESG decisions of a firm (Hörisch et al., 2020). The performance feedback process evaluates any given performance against reference points that a firm planned to exceed or meet (Feigenbaum et al., 1996; Greve, 2003; J. G. March & Shapira, 1992). The literature suggests two main reference points that firms use for performance feedback- their own past performance (historical aspirations) and the past performance of other organizations in the "reference group" (social aspirations) (R. C. March James, 2006). A firm's performance is characterized as good or bad based on how much the existing performance lags or exceeds the historical and social aspiration levels (Cattani et al., 2017). It is, therefore, expected that the influence of firm performance should be backed by a theory that could explain when these reference points are more or less likely to induce firms to be involved in ESG.

In this study, we aim to develop the theory and address this gap by explaining the influence of a firm's performance relative to its aspirations on ESG decisions. To address this gap, we refer to the Behavioural theory of the firm (BTOF), which has clearly mentioned that the difference between aspiration and performance levels could include a change in a firm's behavior (Greve, 2003). We also borrow from the Control theory (Audia & Brion, 2007b; Carver & Scheier, 1981; Klein, 1989), which states that managers focus on important things when their performance falls below aspiration levels due to their limited attention capabilities. So, combining behavioral theory and control theory, we argue that firms have primary and secondary activities that require different attention and performance feedback, which have differential effects on firm behavior. Recent studies have identified the intrinsic differences between social and historical aspirations concerning their origin and impact (Bromiley & Harris, 2014; J.-Y. (Jay) Kim et al., 2015). Accordingly, we suggest that performance below historical and above social aspiration levels decreases ESG engagement. On the other hand, performance above historical and below social aspirations would enhance ESG engagement. We also predict that a CSR committee would positively moderate the relationship between performance feedback and ESG engagement. We test our proposed hypotheses on rich, unique data comprising 561 U.S. firms. Our study explains why performance above aspirations would not always lead to greater ESG engagement (Y. Yuan et al., 2020). Surprisingly, our results revealed that performance above historical aspirations has a negative effect on ESG engagement. Ultimately, we demonstrate that corporate financial performance has either a positive, negative, or no effect on firm behavior concerning ESG engagement, depending on the social and historical aspirations.

This study has made a few crucial contributions to the ESG literature and the behavior of the firm literature. First, we challenge the common theoretical and empirical argument that good performance influences ESG engagement positively by extending the theory to build on the effects of performance above and below social and historical aspirations. Second, we contribute to the extant literature on the behavior theory of the firm by observing that firms could improve their engagement in ESG when there is a CSR committee on the firm's board. Until now, prior research has focussed on primary activities such as lobbying (Rudy & Johnson, 2016), acquisitions (J.-Y. (Jay) Kim et al., 2015), new market entry (Ref & Shapira, 2017), and forming strategic alliances (Tyler & Caner, 2016). Prior literature has not given special attention to whether the historical and social aspirations would similarly influence secondary or non-market-related activities such as ESG engagement. Finally, our study has advanced the research on aspiration levels regarding non-market activities such as ESG engagement and why firms exhibit different interpretations of achievement by combining the behavioral theory of firm and control theory.

2. Theory & Hypotheses Development:

2.1. Performance and corporate social responsibility:

The level at which a firm becomes involved in social initiatives in harmony with the expectations and interests of the stakeholders is known as corporate social responsibility (McWilliams & Siegel, 2000a). The Environmental, Social, and Governance (ESG) score has transpired as a vital part of CSR to develop strategies that could influence corporate financial performance (CFP) (Eccles et al., 2013). Examples of ESG activities include offering work-life benefits to employees, adopting recycling and pollution prevention activities, hiring external auditors, affording more independence to the board of directors, and embracing social features in products and processes (Duque-Grisales & Aguilera-Caracuel, 2021; Shiu & Yang, 2017). The relationship between CSR engagement and corporate financial performance has been debated for a long time. It is classified into three types: (1) a positive relationship, (2) a negative relationship, and (3) a neutral/ no significant relationship. The positive relationship is attributed to the argument that ESG engagement increases financial performance by forming better relationships with various stakeholders (Luo et al., 2017). (Duque-Grisales & Aguilera-Caracuel, 2021) argued that the negative relationship between CSR & CFP could be due to the CSR implementation costs that would not be reflected in firm valuation. Moreover, CSR is considered by many researchers to be a secondary or non-market activity (Hubbard et al., 2017) for which the returns are not available in the short term. (Pekovic et al., 2018) found an inverted U-shape relationship between environmental investment and firm performance, implying that too little or too much environmental investment could be detrimental to firm performance.

While the relationship between performance and ESG engagement is argued heavily in the literature, certain benefits are accorded to the firms engaging in ESG. Investors see ESG as a value addition to the company based on the risk-return balance. Companies that have high ESG scores are seen as less risky by investors as they reflect sustainability in the long term. It can be argued that investors will demand lower returns for such companies, as they would benefit from high firm value (Barnett, 2007). (Amiraslani et al., 2023) found that firms with high ESG performance scores taken as a proxy for social capital could raise more debt for longer maturities and at lower spreads, particularly during crisis periods. ESG engagement would generate tangible assets such as increased performance and help develop intangible assets such as reputational capital, culture, and employee satisfaction (Edmans, 2011; K.-H. Kim et al., 2018).

While companies benefit from ESG engagement, they would not shy away from accepting the costs incurred in the process. The financial benefits that originate from

secondary activities such as ESG are often reflected in the long term, making them difficult to see in the firm's short-term performance (Barney et al., 2011). ESG activities may result in diverting resources from core business activities, which could have been used to improve the firm's performance and produce a clear outcome, unlike ESG investment (Shea & Hawn, 2019).

2.2. Behavioral Theory of the Firm, Control Theory, & Performance Feedback:

Both the behavioral theory of the firm (Cyert & March, 1963) and Control theory (Carver & Scheier, 1981; Klein, 1989; Lord & Levy, 1994) attempt to explain how performance feedback can influence a firm's behavior. While the behavioral theory focuses particularly on how variations in performance influence a firm's propensity to change, the control theory focuses on how variations in performance influence a broad range of human behavior, including the cognitive and affective processes. Both these theories are based on the assumption that individuals act so that the difference between the current and desired outcomes is minimal. Both these theories assume that individuals have limited attention and it is impossible to pay equal attention to all the issues. Therefore, these theories argue that individuals pay greater attention to those issues that are more important to the firm (Audia & Brion, 2007a).

The behavioral theory of the firm posits that organizations toil to reach their aspirations. These aspirations are evaluated against the current performance levels of the firms to check if the performance is above or below the desired aspiration levels. Behavioral scholars argue that there are two aspirational levels: historical and social (Joseph & Gaba, 2015a). Historical aspirations refer to the firm's past performance and may help forecast future performance (Joseph & Gaba, 2015a). Historical aspirations are accessible and reflect the capabilities and resources of a firm (Greve, 2003). Social aspirations, on the other hand, reflect the performance of firms in a reference group and allow for benchmarking (Feigenbaum & Thomas, 1995). A firm's aspiration may rise when its performance exceeds its past performance or the reference group's performance. Similarly, a firm's aspiration may fall either when its performance falls below its past performance or lags behind the performance of the reference group. A firm may engage in a problemistic search when the managers find the performance below the aspiration level (Cyert & March 1963; R. C. March James, 2006). While engaging in a problemistic search, firms would be more willing to make organizational changes by exploring alternative actions (J. G. March & Shapira, 1987).

Even though both the historical and social aspiration levels influence firm behavior, their influence may differ significantly as they arise from different organizational processes

(J.-Y. (Jay) Kim et al., 2015). Since historical and social aspirations vary in the source of performance feedback, they may result in different interpretations, which, in turn, may result in different organizational responses. Historical aspirations are readily available and accurate because they depend on the firm's behavior, derived from its past performance, and reflect its resources and capabilities (Audia & Greve, 2006). Social aspirations, on the other hand, are derived from benchmarking with a reference group and are often characterized by causal ambiguity (Fiegenbaum & Thomas, 1995). While there is no significant evidence that ESG engagement increases when performance falls below the aspiration levels and rises when the performance rises above aspiration levels as per the behavioral theory of the firm, it is vital to understand the differential effects of historical and social aspirations on ESG engagement.

Effects of Historical Aspiration on ESG Engagement:

Performance that exceeds aspiration levels would bring more confidence and increase the motivation of the managers. As the previous aspiration levels are met, the firms would increase their aspiration levels, pushing them above the existing levels (J.-Y. (Jay) Kim et al., 2015). As new aspiration levels are available, managers tend to push their limits ahead to surpass the performance above the aspiration levels by altering the firm's course of action (Tversky & Kahneman, 1974). Managers would compare the firm's current performance with historical aspirations, allowing them to embody ever-evolving realities in their analysis and, therefore, update their aspiration levels accordingly (Levinthal & March, 1981). Since the historical aspirations are derived from the firm's past performance, they closely reflect its capabilities and resources. Historical aspiration is also subject to greater scrutiny as the managers have access to the private knowledge of the firm that exists within the firm (Menon & Pfeffer, 2003). Managers could accurately identify the core business activities that led to the current firm's performance. However, quantifying the ESG engagement would become significantly more challenging as they are not transparent (Barney et al., 2011). The effects of ESG activities on a firm's performance are tricky to observe as they are reflected in the long run and are often non-pecuniary, such as reputational capital, culture, and employee satisfaction (Edmans, 2011; K.-H. Kim et al., 2018). There are a few reasons to expect managers to continue focusing on ESG engagement when their firm's performance exceeds historical aspirations. One of the decisive reasons for a firm to engage in ESG activities is to develop a reputation and thereby reduce borrowing costs (Amiraslani et al., 2023). Investors would demand lower returns from the company as they would benefit from the increased firm value. On the other hand, managers undertake ESG to maximize long-term firm value to align with the social value of the stakeholders, and in some instances, it reflects the top management's values and personal interests (Bénabou & Tirole, 2010). Moreover, when the performance exceeds aspirations, firms do not find the need to revise

what seems to be the “correct strategy,” continuing with the existing strategies is considered more efficient than trying new and untested alternatives.

For the above-stated reasons, managers evaluate the current performance of their firm, and if the performance is above the aspiration levels, they will develop an expectation that increased ESG engagement could benefit the firm in the long term. Therefore, we propose the following hypothesis.

Hypothesis 1a. *As the performance rises above the historical aspiration levels, a firm's ESG engagement increases.*

A firm's performance above the aspiration levels would encourage it to continue in its course of action. However, as the performance falls below the aspiration levels, it could lead to a downward adjustment of their estimation and accordingly adjust their course of action (J.-Y. (Jay) Kim et al., 2015). Performance below the aspiration levels suggests that the firm could not achieve what it was supposed to achieve based on past performance levels. When a firm performs below its aspirations, it reflects that its capabilities and resources are not used efficiently. In addition, it would also enable firms to pinpoint the reasons for underperformance accurately (J.-Y. (Jay) Kim et al., 2015). Managers have the historical data of their firms and would analyze the reasons for their underperformance and make “corrective” adjustments to improve the efficiency of capabilities and resources to achieve the aspiration levels. Given the limited attention capabilities of individuals, control theory argues that managers would divert their attention to the most salient issues in the hierarchy (Klein, 1989). Borrowing from control theory, we argue that any firm's primary and salient task is increasing the shareholders' returns, which would be their main focus area. Since the performance shortfall could be identified accurately based on the historical data, firms would focus on primary actions such as price changes, new product launches, innovation, new market entry, etc., rather than the non-market or secondary activities such as ESG (Hubbard et al., 2017). As discussed above, ESG activities are intended to provide non-pecuniary benefits and can be observed only in the long term. This, in addition to the fact that ESG activities require a firm to divert its resources from core business activities, especially when a firm's performance is below its aspiration levels, draws us to the assumption that firms would reduce their ESG engagement when their performance falls below aspiration levels. Therefore, we propose the following hypothesis:

Hypothesis 1b. *As performance falls below historical aspiration levels, a firm's ESG engagement decreases.*

Effects of Social Aspiration on ESG Engagement:

Social aspirations have differential effects on ESG engagement as these are formed by benchmarking, where firms set their aspiration levels relative to that of a reference group (Fiegenbaum & Thomas, 1995). A firm's performance above that of the reference group is perceived as success, whereas the one that fails to achieve this is less favored. Social aspiration levels indicate how well managers should perform comparatively, and even the stakeholders would expect their firm to perform in line with that of the reference group (J.-Y. (Jay) Kim et al., 2015). Control theory also argues that individuals get motivated to act so that they may reduce the undesired and adverse outcomes. The recent work on aspirations implies that managers focus on social aspirations before attending to other performance benchmarks (Audia & Brion, 2007a). Even though social aspiration level is a valuable benchmark, it is not easy to clearly decipher performance as learning from others is intrinsically difficult compared to learning from oneself (J. A. Baum & Ingram, 2002). It is not easy to interpret the performance of other firms as managers need internal data from those firms, which is not available to external parties (Menon & Pfeffer, 2003). Social aspirations offer little information due to the causality in the performance of other firms. The focal firm would be blind when it comes to accurately interpreting other firm's performance with the limited data available in the public domain.

When a firm's performance is above the social aspiration level, managers should first be able to identify why their firm performed better than the reference group. If the managers conclude their performance is due to their capabilities and resources, they will continue the current course of action. Managers would have a clear understanding of their firm's resources and capabilities but may not be able to interpret the capabilities and resources of the firms in the reference group (J. A. Baum & Ingram, 2002). Managers need to compare their capabilities with others in the reference group to credit the performance to them. However, given the heterogeneity among firms in the reference group, managers find it difficult to compare the capabilities and resources that led to the performance (Beckman & Haunschild, 2002). According to the predictions made by control theory, when the primary performance is high, individuals will have a lesser propensity to make changes (Audia & Brion, 2007a). (Klein, 1989) if no error is detected, i.e., no performance shortfall, then the behavior will not change. Moreover, pressure-sensitive institutional investors who prefer short-term results would reduce their focus on ESG engagement as it would not yield short-term results (J. Liu et al., 2023). As the primary performance measure, i.e., firm performance, increases above the social aspiration levels, firms would reduce their focus on the secondary performance measure, ESG engagement, as they are performing better than the reference group, and also, it reduces the pressure from stakeholders. As ESG activities generate non-pecuniary benefits and are targeted in the long term, firms may reduce their ESG engagement, providing them immediate cost

advantages by diverting these resources to the core activities (Xu et al., 2018). This draws us to the assumption that when a firm performs above its social aspirations, it will reduce its engagement in ESG activities. Therefore, we propose the following hypothesis:

Hypothesis 2a. *As performance rises above social aspiration levels, a firm's ESG engagement decreases.*

Contrastingly, when a firm fails to meet the social aspiration levels, pressure is created from internal and external stakeholders, as they assume that they are not performing up to their potential. A firm's managers are expected to perform at par or exceed competitors' performance in the reference group (J.-Y. (Jay) Kim et al., 2015). When faced with performance shortfalls, managers would make corrective adjustments to rectify the performance and keep it at par with the reference group (J.-Y. (Jay) Kim et al., 2015). However, managers would be unable to correctly identify which measures should be taken, as the feedback from the reference group would suffer from causal ambiguity. When confronted with ambiguity, managers prefer strategies that can generate immediate returns to offset the prior losses (Conell & Cohn, 1995). Therefore, managers may engage in ESG activities as there would be a positive market reaction to the positive ESG news, focusing on short-term actions (Serafeim & Yoon, 2023). We conclude that more critical performance measures are adopted and are considered the primary focus of attention when the performance falls below the social aspiration levels. Control and behavioral theories also support our argument that firms would be motivated to change when their performance is not as expected. Accordingly, we propose:

Hypothesis 2b. *As performance falls below social aspiration levels, a firm's ESG engagement increases.*

3. Methodology:

3.1. Sample & Data Collection:

The sample for this study was collected from the Environmental, Social, and Governance (ESG) database maintained by Thompson Reuters REFINITIV (Asset 4 ESG Platform). These ratings are given equal weightage to more than 250 key performance indicators from the Environment, Social, and Governance sections.

The study has considered all the publicly listed companies for which the data points are available for sample years 2013-2022 in the NYSE benchmark index, thereby effectively mitigating any type of sample selection and composition bias (H. Kim et al., 2017). The

dataset includes companies of various sizes in various industries and is considered the most comprehensive dataset available (Shi & Veenstra, 2021). All the financial details are also obtained from the same database. After excluding the missing data points, we were left with a final sample of 561 firms with 4080 firm-year observations between 2013-2022.

3.2. Measures:

Dependent Variable:

The dependent variable for our study is the ESG engagement of a firm measured by the ESG activities undertaken by the firm in a given year. Consistent with previous studies, we measured ESG engagement based on the ESG score in the Thompson Reuters REFINITIV database (Aouadi & Marsat, 2018; Reber et al., 2022; Shi & Veenstra, 2021). The Asset 4 ESG database ratings are standardized and normalized to position the score between 0 and 100, with 0 being the lowest and 100 being the highest. Asset 4 assigns a **z-score** in each year '**t**' for each of the four pillars of a firm by benchmarking its performance against the rest of the firms based on the available information in the preceding year **t-1**. For example, the social or environmental performance of a firm in the year 2022 reflects the investment made by the firm in these areas in 2021, thereby creating an in-built lag in the ESG scores.

Independent Variable:

The independent variable of our study is the performance feedback, which is arrived at by considering both the historical and social aspiration levels. We have taken Return On Assets (ROA) in line with the previous studies to measure performance (Shi & Veenstra, 2021). ROA is the ratio of net income to a firm's total assets, and it varies from one company to another based on its managerial policies and relative efficiency of asset utilization. Nevertheless, ROA is an accounting-based measure and is found to be a better predictor of ESG than other measures (Choi & Wang, 2009). We have also run an additional analysis with Tobin's Q as an indicator of firm performance, considering that different performance measures represent different types of firm value. ROA is an accounting-based performance measure, whereas Tobin's Q is a market-based measure of firm performance and is frequently used to study different effects of firm performance (Kang et al., 2016; Petrenko et al., 2016; Price & Sun, 2017).

Historical aspiration levels are measured by taking the weighted moving average of a firm's performance (Levinthal & March 1981). The function for calculating historical aspiration levels is given as

$$\text{Historical Aspiration}_{i,t} = \alpha * \text{Performance}_{i,t-1} + (1-\alpha) \text{Historical Aspiration}_{i,t-1}$$

where Historical aspiration_{*i, t*} is the historical aspiration of a firm *i* at time *t*; Performance_{*i, t-1*} is the ROA performance of a firm *i* in the year *t-1*; α is the weight assigned to the most recent aspiration level, higher value denotes greater weight to recent aspiration levels. We have taken the value of α as 0.75, which yielded the maximum value, and estimated this value of α by searching for all the possible values with increments of 0.1 (Joseph & Gaba, 2015a).

We then construct our social aspiration levels by measuring the average performance of the firms that belong to the relevant group (Audia & Greve, 2006). The relevant group is defined as the one that has the same SIC code as the focal firm. Our social aspiration is calculated per the formula:

$$\text{Social Aspiration}_{i,t} = \sum \text{Performance}_{j,t} / N \quad (j \neq i)$$

where Performance_{*j, t*} is the ROA performance of a competitor *j* in year *t*, and *N* is the total number of firm “*i*” competitors taken by excluding the focal firm from the calculations.

We have constructed separate variables for performance above and below historical and social aspirations (Harris & Bromiley, 2007; J.-Y. (Jay) Kim et al., 2015) and employed a spine function to estimate the difference between aspirations and performance.

Performance below aspiration was arrived at by subtracting ROA_{*i, t*} from Historical/ Social Aspiration_{*i, t*}. On the other hand, for performance above aspiration, we have subtracted Historical/ Social aspiration_{*i, t*} from ROA_{*i, t*}. We have taken the absolute values of all performance-aspiration variables for ease of interpretation. All the negative values are replaced by zero while retaining the positive values (Kuusela et al., 2017).

Control Variables:

We have included several control variables in our models to prevent the possibility of these variables driving the findings. As large firms would have more resources to engage in CSR activities than small firms (Borghesi et al., 2014), we have controlled for the firm's size by including the logarithmic transformation of the *Number of employees* (Employees). The logarithmic transformation of *Asset value* is also considered a size variable (Assets) and is also found to be correlated with the number of employees (Greve, 2003). Firms with higher debt ratios spend less on CSR activities as they primarily need to support the debt holders, so we controlled the *Debt ratio* by incorporating the long-term debt-to-assets ratio in our models (Brammer & Millington, 2008). The

availability of slack resources could enhance a firm's involvement in ESG activities. Therefore, we controlled for *Slack*, which was measured as the ratio of current assets to current liabilities (Joseph & Gaba, 2015b). R&D intensity and ESG engagement are found to be positively correlated as higher levels of R&D lead to the development of innovative products and are also considered to be an alternative use of a firm's resources (Cohen & Levinthal, 1990). We controlled for *R&D intensity*, which was measured as the ratio of R&D investment to the total assets. We also control the advertising expenses made by the firms, as the ESG performance score could be influenced partly by the advertising campaigns (McWilliams & Siegel, 2000b). *Advertising Intensity* is measured as the ratio of advertising expenses to total assets. Finally, we control for the *firm's Age* as firms become much more responsible with age regarding diversity and environmental awareness. Age is calculated by subtracting the year of incorporation of the firm from the current year (Oh et al., 2011).

Industry competition positively influences ESG engagement (Tang et al., 2015) and is controlled using the *Industry concentration ratio*. The industry concentration ratio is computed using the Herfindahl- Hirschman Index (HHI- Sector) as the sum of market shares squared of all companies in a given SIC code and year. We include *industry and year dummies* to control for unobserved, time-invariant, and firm-specific heterogeneity (Joseph & Gaba, 2015b).

4. Results:

We used the fixed effects estimation model to test the hypothesis as it accounts for firm-level standard errors. **Table 1** consists of the descriptive statistics and the correlation matrix for the main variables involved in the study. Variance Inflation factor (VIF), which indicates the multicollinearity, was found to have a maximum value of 1.43, which was way below the specified limit of 10, confirming the absence of multicollinearity (Hair et al., 2012).

Table 2 presents the regression results for fixed effects models. Model 1 reports the fixed effects model of all the control variables. Model 2 includes four independent variables discussing the performance feedback: Performance above historical aspirations, Performance below historical aspirations, Performance above social aspirations, and Performance below social aspirations. The results in model 2 are different from the proposed hypotheses. Performance above historical aspiration was proposed to be positive, but the results presented in model 2 reveal it to be negative and insignificant ($b = -4.664$, S.E. -0.76). On the other hand, the performance below historical aspiration was negative and significant, which was in line with the proposed hypothesis ($b = -26.93$,

S.E.= -4.15). *However, we found support only for H1b, but not for H1a.* Performance above social aspiration was hypothesized to be negative, and the results from Model 2 reflect that it is in line with the hypothesis, i.e., negative and significant ($b = -17.06$, S.E.= -2.93), whereas Performance below social aspiration is positive and insignificant ($b = 13.38$, S.E.= 1.85). *Therefore, only H2a is supported, not H2b.*

5. Robustness Tests:

We performed supplemental analysis to check if the tests would hold to alternative specifications. First, we have used Tobin's Q to estimate our independent variable, performance feedback. We have adopted the method to calculate Tobin's Q from (Chung & Pruitt, 1994). Tobin's Q is a forward-looking measure of firm performance and overcomes the weaknesses of traditional accounting measures (Brainard & Tobin, 1968). The results presented in Model 4 are consistent with our main findings in Model 2, with varying significance levels. The significant difference could be that ESG engagement increases a firm's legitimacy but produces uncertain economic returns, reflected in the performance above historical aspiration.

Second, we checked if the results were consistent when the financial firms were excluded from the sample. Financial firms like banks, insurance companies, investment trusts, etc., have different accounting and reporting rules and capital structures from regular firms (C. (Francis) Kim & Zhang, 2016; R. Yuan et al., 2016). Model 6 presents the results after excluding the financial firms. The results are consistent with our main findings. The significance level has been reduced for performance above social aspirations but remained the same for performance below historical aspirations.

Third, we also checked if the results held for the before and covid scenarios. Firms react differently to different situations. Firms are found to invest heavily in ESG activities in times of financial crisis, which can be seen in the Covid-19-induced crisis. Adopting solid and robust ESG measures can contribute to the stability and liquidity of firms' stock prices (L. Liu et al., 2023). Firms with high ESG engagement are found to perform better than other firms, and this was tested during the COVID-19 crisis by bifurcating the sample into before and after COVID-19 (Asteriou et al., n.d.). The results in Model 7 and Model 8 are before covid and after covid, respectively. The findings in these models are almost consistent with our main findings.

6. Discussion & Conclusion:

The primary purpose of this paper is to examine if firms would take “corrective actions” regarding ESG engagement when their performance is below their aspirations. As the behavioral theory of firm scholars argues, firms would make strategic changes when the performance falls below their aspirations (Cyert & March 1963; R. C. March James, 2006). These changes include primary or market activities such as price changes, acquisitions (J.-Y. (Jay) Kim et al., 2015), new product launches (Audia & Greve, 2006; Parker et al., 2017), innovation (Greve, 2003), new market entry (Ref & Shapira, 2017), internationalization (Lin, 2014) etc. and secondary or non-market activities such as corporate political activity (Rudy & Johnson, 2016), ESG engagement (Saridakis et al., 2023) etc. We argued from control theory that firms would not engage in ESG activities when their performance was below aspiration levels. Control theory proposes that firms focus on issues that are more important to all the stakeholders when their performance is below their aspiration levels. Since ESG engagement is a secondary or non-market activity, we argue that firms would instead focus on primary activities as a part of “corrective action” and have obtained support for our hypothesis.

Surprisingly, our empirical analysis showed that firms would not engage in ESG activities in any case, i.e., when the performance is above or below the social and historical aspiration levels. We contradict our results with previous studies, which state that firm performance will lead to higher engagement in CSR activities (Melo, 2012; Tang et al., 2015, 2018). We find that when performance falls below historical aspiration levels, a firm’s engagement in ESG activities decreases. We align this finding with the control theory, which states that when performance is below aspiration levels, managers will focus on more salient activities that could improve their performance in the short term rather than those with a long-term effect (Audia & Brion, 2007b).

We have also contributed to the *firm's behavioural theory* by examining the differential effects of performance feedback with respect to ESG activities. (J.-Y. (Jay) Kim et al., 2015) revealed the differential effects of performance feedback concerning primary or market activities and found no uniform pattern in which the social and historical aspirations would affect the strategic change. We have also proved the differential effects of performance feedback with respect to secondary or non-market activity, i.e., ESG engagement. One reason for the differential effects is the difference in the quality of information these aspirations provide to the managers. Historical aspirations reveal the firm's capabilities and resources, whereas social aspirations suffer from causal ambiguity, influencing ESG engagement. Historical aspirations can be easily compared against performance as the data regarding the firm's capabilities and resources would be readily available to the managers, helping them pinpoint the deficiencies to take corrective actions. On the other hand, with respect to social aspirations, firms can only observe the

outcomes of the firms in the reference group rather than the process that led to these outcomes, creating an ambiguous situation (Conell & Cohn, 1995).

To our knowledge, this is the first study that has combined both the *behavior theory of the firm* and *Control theory* to argue the differential effects of performance feedback when it comes to secondary or non-market activities, mainly focusing on ESG engagement. When performance falls below the aspiration levels, behavioral theory proposes that firms take corrective action. But, we have borrowed from control theory to state that firms would take corrective action on those things that they think are more salient and bring results in the short term. Since ESG activities are long-term focussed, firms would turn to short-term activities such as primary or market-related activities. As the firms have internal data, they could specify the exact reasons for the shortfall and act on them. However, in the case of social aspirations, firms would be under pressure from internal and external stakeholders when their performance is below the aspiration levels. In such cases, managers would turn to short-term activities such as ESG engagement to improve their credibility and reduce the pressure to a certain extent. Therefore, we have argued and proved that when performance falls below historical aspiration levels, firms reduce their ESG engagement but increase ESG activities when performance falls below social aspiration levels.

7. Limitations and future research:

Our study has certain limitations despite its richness in theoretical and empirical ways. First and foremost, our sample consists of companies from the United States and is not very extensive. There could be particular idiosyncrasies that prevent us from generalizing our findings. Further studies could focus on combining developed and emerging countries to check if these results hold true. We have taken the social aspiration given by previous studies (Joseph & Gaba, 2015b), but future studies could take a different measure of social aspirations. With increasing technology, firms are operating in different industries. Some firms carry out their operations across multiple industries simultaneously (Tanriverdi, 2006), and this measure may not be accurate for them. For example, Amazon, which started as a bookseller, later expanded into various industries, blurring the boundary. So, future studies may develop a social aspiration measure for firms that operate across multiple industries. We have used the ESG score from the Thompson Reuters REFINITIV database as a proxy for ESG engagement. This score indicates a firm's environmental, Social, and Governance performance. ESG performance is different from ESG disclosure. ESG disclosure score is calculated based on the information obtained from CSR reports, company websites, and annual reports. For certain firms, ESG performance and ESG disclosure would not be the same as they may report more than they actually performed. The difference between the ESG performance and the ESG

disclosure scores is known as ESG decoupling (Eliwa et al., 2023; Gull et al., 2023). Future studies could look into the effect of performance feedback on the ESG decoupling.

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Table 1:

	1	2	3	4	5	6	7	8	9	10	11	12	13	14
(1) ESG_P	1.000													
(2) CSR committee	0.561	1.000												
(3) PLHA_ROA	-0.085	-0.051	1.000											
(4) PMHA_ROA	-0.016	0.011	-0.185	1.000										
(5) PLSA_ROA	-0.060	-0.030	0.394	-0.164	1.000									
(6) PMSA_ROA	0.014	0.004	-0.085	0.445	-0.341	1.000								
(7) Slack	-0.231	-0.175	0.096	0.070	0.031	0.124	1.000							
(8) AGE	0.162	0.088	-0.030	-0.035	0.005	-0.031	-0.059	1.000						
(9) RDIntensity	0.093	-0.002	-0.052	-0.006	-0.104	0.093	0.145	0.040	1.000					
(10) Advertising Intensity	0.067	0.023	0.003	-0.010	-0.023	0.117	-0.004	0.038	-0.009	1.000				
(11) DebtRatio	0.018	0.010	0.015	0.017	0.043	0.084	-0.125	-0.032	-0.081	-0.037	1.000			
(12) HHI_Sector	-0.012	-0.035	-0.003	-0.006	0.042	-0.019	-0.041	-0.001	-0.094	0.067	-0.043	1.000		
(13) lassets	0.505	0.366	-0.103	-0.092	-0.130	-0.131	-0.365	0.079	-0.022	-0.100	0.007	0.011	1.000	
(14) lEmployees	0.463	0.218	-0.069	-0.115	-0.017	-0.052	-0.198	0.107	0.024	0.073	-0.046	0.180	0.556	1.000

Mean	55.044	0.635	0.010	0.010	0.020	0.018	1.664	38.839	0.007	0.008	0.283	0.148	23.400	9.410
S.D.	18.959	0.481	0.023	0.025	0.028	0.038	0.943	28.779	0.024	0.022	0.198	0.184	1.430	1.690

Table 2:

Results- ESG Perf						
	Model (1)	Model (2)	Model (4)	Model (6)	Model (7)	Model (8)
	F.E Regression Model- Only Controls	F.E Regression Model- ROA	F.E Regression Model- Tobins'Q	F.E Regression Model- ROA- Excluding Financial Companies	F.E Regression Model- ROA- Before Covid	F.E Regression Model- ROA- After Covid
Slack	-0.524*	-0.511*	-0.545*	-0.526*	0.162	-0.678
	(-2.14)	(-2.10)	(-2.24)	(-1.99)	-0.56	(-1.48)
AGE	2.026***	2.016***	2.029***	1.999***	1.798***	2.181***
	30.89	30.39	26.49	29.8	20.39	12.03
R&D Intensity	-12.44	-11.65	-9.459	-10.94	5.206	-23.72
	(-1.08)	(-1.01)	(-0.82)	(-0.96)	-0.44	(-0.68)
Advertising Intensity	-4.369	-4.577	-4.832	-5.568	-12.25	-55.56
	(-0.31)	(-0.32)	(-0.34)	(-0.39)	(-0.76)	(-1.67)
DebtRatio	3.031*	3.396**	3.370**	3.588**	2.181	5.288
	2.42	2.71	2.69	2.87	1.58	1.89
Industry Concentration Ratio	-0.728	-1.376	-0.439	-1.692	-1.616	9.36

	(-0.18)	(-0.34)	(-0.11)	(-0.41)	(-0.35)	-1.62
Assets (Logged)	1.052	1.1	0.205	1.207*	1.962*	-0.0104
	1.78	1.86	0.3	2.03	2.56	(-0.01)
Employees (Logged)	2.367***	2.229***	2.177***	2.318***	1.378	0.602
	4.54	4.28	4.16	4.43	1.87	0.98
Performance Below Historical Aspiration		-26.93***	-0.807***	-24.15***	-29.60***	-8.261
		(-4.15)	(-3.32)	(-3.71)	(-3.62)	(-1.14)
Performance Above Historical Aspiration		-4.664	-0.388	-4.092	0.156	0.373
		(-0.76)	(-1.04)	(-0.67)	0.02	0.05
Performance Below Social Aspiration		13.38	0.3	12.39	13.77	4.353
		1.85	0.63	1.71	1.38	0.45
Performance Above Social Aspiration		-17.06**	-0.442**	-15.24**	-26.80***	6.654
		(-2.93)	(-3.21)	(-2.62)	(-3.44)	0.74
_cons	-72.51***	-71.33***	-50.79***	-73.76***	-75.62***	-39.51
	(-6.49)	(-6.35)	(-3.86)	(-6.52)	(-5.28)	(-1.43)
Industry Dummies	Yes	Yes	Yes	Yes	Yes	Yes
Year Dummies	Yes	Yes	Yes	Yes	Yes	Yes
N (Observations)	4080	4080	4074	3924	2830	1250
F	184.68	150.16	149.64	146.25	66.01	19.37
R-Squared	0.040	0.040	0.036	0.041	0.040	0.014
t statistics in parentheses	* p<0.05, **p<0.01, ***p<0.001					

