Unveiling the critical role of marketing department power and firm reputation in the relationship between ESG investments and firm performance

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We investigate the role of marketing in the relationship between ESG investments and firm performance on a sample of 247 S&P500 firms from 2013 to 2022. Specifically, we address two important questions. First, is the relationship between ESG investments and firm performance contingent upon the power of the marketing department in a firm? Second, what is the mechanism that may explain this relationship? To answer the first question, we show that the relationship between ESG investments and firm performance is strengthened by the marketing department's power. To answer the second question, we show that firm reputation mediates the relationship between ESG investments and firm performance. These findings provide new insights to marketing scholars and managers with regard to the marketing department's contribution in enhancing the effect of ESG investments on firm performance, as well as the role of firm reputation in transmitting the positive impact of ESG investments on firm performance.

Key Words: ESG investments, firm reputation, marketing department power
Conference track: Marketing Strategy & Theory

1. Research Goals and Significance

Extant research has shown an inconclusive relationship between ESG investments and firm performance. For example, in a meta-analysis of research on ESG investments and performance of corporate firms, 58% of the studies showed a positive relationship, 13% showed no significant relationship, 21% showed mixed results (that is, some performance outcomes were positive, and others were negative or non-significant), and 8% showed a negative relationship between ESG investments and firm performance (Whelan, Atz, Van Holt, & Clark, 2021). These conflicting findings about the causal relationship between ESG investments and firm performance have raised two important questions. First, under what conditions do the ESG investments result in positive firm performance? Second, what mechanism may explain this relationship between ESG investments and firm performance? In this research, we propose that the positive effect of ESG investments on firm performance is contingent upon the *marketing department's power*. We also propose that *firm reputation* is a critical mediating mechanism for the relationship between ESG investments and firm performance.

2. Hypotheses

In this section, we present arguments for the hypothsized relationships. First, we discuss the moderating role of marketing department power; second, we discuss the mediating role of firm reputation.

2.1 Moderating role of marketing power

The power of the marketing department is its ability to influence other departments in the firm (Feng, Morgan, and Rego, 2015). It is reflected in greater authority and control over the decisions and actions of other departments (Brass & Burkhardt, 1993). A more powerful marketing department will receive higher-quality resources, promotions, and pay raises. These resources enable the marketing department to attract superior talent relative to other departments within the firm and its competitors.

The marketing department often requires input and cooperation from other departments to understand external stakeholders' needs, and to communicate with external stakeholders. For example, the marketing department may require input from the purchasing department to identify the ESG initiatives taken by its suppliers to reduce waste management. Further, the marketing department requires cooperation from top management and other departments to communicate these initiatives to other stakeholders, such as shareholders, customers, and prospective employees.

A more powerful marketing department is better able to draw the top management's attention to such issues to gain their cooperation, influence other departments to accomplish these tasks, and influence top management's strategic decisions to be more aligned with the orientation of the marketing department. Targeted communication of various ESG initiatives to diverse stakeholders will positively affect their interactions with the firm, such as attracting new customers, attracting and retaining talented employees, and drawing reliable suppliers. These improved interactions with diverse stakeholders will positively influence firm performance, resulting in higher firm value. Such is not the case for marketing departments with less power. Therefore, we hypothesize:

H1: Marketing power enhances the positive relationship between ESG investments and firm value.

2.2 Mediating role of firm reputation

Reputation has traditionally been described as an overall appraisal of a firm by stakeholders based on its past actions and future outlook, as well as their assessments of its capabilities, qualities, or outputs (Boivie, Graffin, and Gentry, 2016; Ferguson, Deephouse, and Ferguson, 2000). Firm reputation is manifested in a firm's product quality; innovativeness; management; leadership; social responsibility; financial performance; and ability to attract, develop, and keep employees (Aksoy, Banda, Harmeling, Keiningham, and Pansari, 2022; Keller & Swaminathan, 2020; Parker, Krause, and Devers, 2019). Research shows that a firm's reputation positively influences its long-term financial performance (Hollenbeck, 2018; Pfarrer, Pollock, Barnett, & Rindova, 2010; Roberts & Dowling, 2002). Therefore, firm managers monitor their own and other firms' reputations, relying on available reputation indices in the public domain, including Fortune's Most Admired Companies, the Harris Poll's Reputation Quotient, and the Reputation Institute's RepTrack.

Firms invest in sustainability initiatives to protect and enhance firm reputation (Fombrun & Shanley, 1990; Fombrun, 2012; Freeman, Harrison, and Wicks, 2007). Several studies note the benefits of a firm's investment in sustainability. For example, research shows a positive impact of a firm's sustainability initiatives on purchase intentions and willingness to pay (Carter, Jayachandran, and Murdock, 2021). Reaserh also shows a positive relationship between a firm's social responsibility and consumers' attitudes toward the firm (Wagner, Lutz, and Weitz, 2009), customer satisfaction (Luo & Bhattacharya, 2006), and financial performance (Mishra & Modi, 2016).

Compared to a firm with lower ESG investment, a firm with higher ESG investment will likely try to communicate and promote ESG initiatives to its stakeholders. For example, the firm will use its website and social media channels to promote actions taken for environmental responsibility of its products and business operations to reach its customers, suppliers, and prospective employees. It will mention these efforts in the annual report (e.g., in a letter written by the CEO to the shareholders) to signal its environmental responsibility. This communication and promotion of ESG initiatives to the stakeholders will likely enhance the firm's appraisal in the eyes of its stakeholders – that is, its reputation, which will positively affect its firm value. Therefore, we hypothesize:

H2: Firm reputation mediates the positive relationship between ESG investments and firm value.

3. Methodology & Modelling Approach

3.1 Research Design & Data

To enable us to test our hypotheses in a large sample of publicly listed firms over a long period, we adopt a secondary data-based approach and include S&P firms from 2013 to 2022 in our initial dataset. We use multiple data sources to collect data. Specifically, we use the MSCI database for ESG ratings, the ExecuComp database to compute marketing department power from top management team (TMT) information, and Compustat for measures of financial performance and control variables. For reputation data, we requested Fortune Magazine to provide us with the overall reputation data of the world's most admired companies (WMAC). Our final sample consists of 247 firms for a total of 1,736 observations, for which we had information on all the variables included in our model.

3.2 Variable Measurement

We use MSCI weighted average ESG ratings as a proxy to measure ESG investments, because these ratings represent how well a firm performs on relevant ESG factors. We use Fortune Magazine's overall reputation score for each firm in each year to represent firm reputation. We compute marketing department power by following the procedure specified by Feng et al. (2015). Specifically, we use Compustat's Execucomp database to use TMT information on (1) compensation of marketing executives relative to TMT, (2) number of marketing executives relative to TMT, (3) highest rank of marketing TMT executive, (4) cumulative rank of marketing TMT executives, and (5) number of responsibilities of marketing TMT executives. Because TMT composition and marketing representation in TMT may vary across industries, we re-scale each of these five indicators relative to the average score for the industry (using primary SIC code) to which each firm belonged in each year. We factor analysed the five indicators using principal factor analysis. Results show that indicators were highly correlated (ranging from .77 to .93) and loaded onto a single factor, explaining 89% of the total variance. We re-scaled the saved Barlett factor scores between 1 and 100 to indicate the marketing department power score for each firm-year observation.

We use stock returns as our measure of firm performance and follow Srinivasan & Hanssens (2009) to compute stock returns for firm 'i' in year 't' as the change in the total value of an investment in common stock over the last year, defined as:

$$\text{Stock Returns}_{it} = (\text{Price}_{it} + \text{Dividend}_{it} - \text{Price}_{i(t-1)}) / (\text{Price}_{i(t-1)}) \qquad (1)$$

We compute return on assets (ROA) as earnings before interest, taxes, depreciation, and amortization (EBITDA) divided by total assets, firm size as the natural log of total assets, competitive intensity as the Hirschmann–Herfindahl index (HHI), and diversification as the number of SBUs (SIC codes that a firm belonged to in each year in Compustat segment data). We include these variables as control variables in our models because these variables effected firm performance in previous research (e.g., Feng et al., 2015).

3.3 Modelling Approach

To test our moderation hypothesis (H1), we addressed omitted variable bias by identifying and including variables that may affect firm performance, based on existing research in marketing (e.g., Feng, Morgan, and Rego, 2015; Leonidou, Katsikeas, and Morgan, 2013). As an identifying assumption of this approach, we anticipate that the control variables and fixed effects proxy for all important omitted variables that influence ESG investments, marketing department power (potentially endogenous variables), and firm performance. We included return-on-assets (ROA), as well as lagged values of firm size, industry concentration, and diversification, as control variables in our model (see Equation 2).

Firms in our data set compete in many different industry sectors, and ESG investments and the financial performance of firms might differ systematically across them. Therefore, we control for time-invariant, industry-specific effects and include dummy variables for the industry sectors to which each firm in our data set belonged. Further, observations in our data set come from different years (2013–2022), so we account for common unobserved time shocks by including year-specific dummy variables in the model specification. Last, to account for multiple observations for each firm in our dataset, we identified each firm as a cluster in a cluster-robust errors model (Wooldridge, 2003). Formally,

$$\text{Stock Returns}_{it} = \beta_0 + \beta_1 \text{ ROA}_{it} + \beta_2 \text{ ESG Investments}_{i(t-1)} + \beta_2 \text{ Marketing Power}_{i(t-1)} + \beta_4 (\text{ESG Investments}_{i(t-1)} \times \text{Marketing Power}_{i(t-1)}) + \beta_5 \text{ Size}_{i(t-1)} + \beta_6 \text{ Industry Concentration}_{i(t-1)} + \beta_7 \text{ Diversification}_{i(t-1)} + \text{FE}_{it} + \varepsilon_{it}. \tag{2}$$

We used FE_{it} to capture all time-invariant, industry-specific, and year-specific fixed effects across all observations, and we assumed that the control variables and FE_{it} capture all unobserved variation correlating with our focal independent variables, which otherwise would be part of the error term ε_{it}. Any remaining unobserved variation in the error term should correlate with the dependent variables, but not systematically with our focal independent variables or any of the control variables.

To test our mediation hypotheses (H2), we used Hayes's (2017) PROCESS procedure, which runs simple OLS regressions with and without mediating variables to compute relative direct and relative indirect effects of the independent variable (in our case, ESG investments) on the dependent variable (in our case, stock returns). The process macro then uses bootstrapping to test the significance of relative indirect effects. We included all control variables mentioned in Equation 2 above to test our mediation model.

4. Research Findings

We present the descriptive statistics and correlation matrix of all the variables in Table 1. We present the results of model estimates for our hypothesis 1 related to the moderating role of marketing department power in Table 2. Model 1a considers the direct effects only, and its results do not support a significant relationship between the direct effect of ESG investments on stock returns ($b = -.05$, $p > .1$). However, the interaction term (ESG investment x marketing department power) in model 1b is positive and significant ($b = .15$, $p < .05$), showing support for our hypothesis 1, which proposes that marketing department power enhances the positive relationship between ESG investments and firm performance.

Table 1. Descriptive Statistics and Correlations.
(N = 1,736)

		Mean	SD	Min	Max	2	3	4	5	6	7	8
1	ESG Investments $_{(t-1)}$	4.85	1.04	0.90	8.20	.04	.11	.07	.00	-.06	.09	-.07
2	Marketing Power $_{(t-1)}$	9.08	11.38	1.00	73.96		.10	-.05	.05	.11	.04	-.01
3	Reputation	6.33	0.84	3.30	8.80			.09	.21	-.01	.16	.14
4	Diversification $_{(t-1)}$	4.07	2.59	1.00	24.00				.19	.05	-.14	-.10
5	Firm Size $_{(t-1)}$	10.39	1.41	7.07	14.97					-.10	-.47	-.12
6	Industry Con. $_{(t-1)}$	0.26	0.21	0.05	1.00						.08	.03
7	ROA $_{t}$	13.56	8.78	-116.30	47.10							.10
8	Stock Returns	23.37	80.95	-59.13	622.82							1.00

Notes:
All correlations greater than the absolute value of .05 are significant at $p < .05$.
ROA = return on assets; Industry Con. = Industry Concentration

Table 2. Stock Returns Models to Test Hypothesis 1

	Standardized regression estimates (Cluster-robust standard errors)	
	Model 1a: Direct effects	Model 1b: Full model
ROA $_{t}$	.01 (.42)	.01 (.42)
ESG Investments $_{(t-1)}$	-.05 (3.21)	-.07 (3.50)
Marketing Power $_{(t-1)}$	-.01 (.24)	-.15** (.50)
ESG Investments $_{(t-1)}$ **×** ***Marketing Power*** $_{(t-1)}$	**-**	***.15** (.10)***
Firm Size $_{(t-1)}$	-.26** (6.62)	-.26** (6.63)
Industry Concentration $_{(t-1)}$	.69 (331.68)	.69 (331.77)
Diversification $_{(t-1)}$	-.07 (1.82)	-.07 (1.82)
Industry fixed-effects	Yes	Yes
Year fixed-effects	Yes	Yes
Number of observations	1736	1736
R^2	.246	.247

** $p < .05$

Table 3. Mediation Model to Test Hypothesis 2 Using PROCESS (Hayes, 2017)

DV / Predictor	Unstandardized estimate
DV: Reputation. Effect of ESG Investments	.09**
DV: Stock Returns. Direct effect of ESG Investments	-6.52***
DV: Stock Returns. Indirect effect of ESG Investments through Reputation	1.63** [a]
DV: Stock Returns. Effect of Reputation	18.67***
Number of Observations	1,736

** $p < .05$, *** $p < .01$

Notes:
All parameter estimates are unstandardized estimates.
[a] Confidence interval excludes zero.
We also included the control variables of our models 1a and 1b in our mediation model.

For our hypothesis 2, we were interested in assessing the theoretical mechanisms that account for the relationship between ESG investments and firm performance. Table 3 shows the mediation test using Hayes's (2017) PROCESS procedure. In line with our expectations, ESG invetments positively affect firm reputation (mediator) in the first stage of the mediated model ($d = .09$, $p < .05$). Similarly, the indirect effect of ESG investments on firm performance is positive and significant ($d = 1.63$, $p < .05$). However, the direct effect of ESG investments on firm performance is negative and significant ($d = -6.52$, $p < .05$), suggesting partial mediation.

5. Implications for Theory and Practice

To our knowledge, the role of marketing has not yet been investigated in the ESG investments – firm performance relationship. By showing the differential roles that marketing department power and firm reputation play in the relationship between ESG investments and firm performance, we make initial theoretical contributions to this emerging area of academic research. This research has economic, social, and environmental benefits for diverse communities. First, it will benefit businesses by informing managers on the role and significance of marketing function in enhancing and transmitting the positive impact of ESG scores on firm value. Second, it will also benefit the societies in which these businesses operate; results of this project will encourage businesses to keep investing in ESG initiatives and empower their marketing department to effectively implement and then communicate these benefits to all stakeholders, such as customers, employees, and local communities to improve firm's reputation and market value. Because ESG initiatives target these stakeholders, sustained ESG investments made by firms benefit these stakeholders and society.

6. Limitations and Further Steps

In this paper, we present early and preliminary results. We need to validate the veracity of the data before we move forward. In terms of further data analysis, we will use the mediation method proposed by Laghaie & Otter (2023) to overcome the known limitations of Hayes (2017) method. For our moderation hypothesis, we will also include an instrument variable or a control function approach to overcome endogeneity concerns. Further, we also intend to include accounting-based outcome variables (such as ROA), market performance-based outcome variables (such as sales growth), and alternate market value variables (such as Tobin's q, idiosyncratic risk, and total shareholder returns) in our analyses to investigate the role of marketing department power and firm reputation in the relationship between ESG investments and firm performance.

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