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CRITICAL PRAGMATISM IN THE CONSCIOUS ASSUMPTION OF RISKS IN ESG STOCK OPTION INVESTMENT

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Resumo
Discussions about ESG (Environmental, Social, and Governance) investments have become significant within the financial field, especially concerning two aspects: the divergence in standards of ESG labels and ratings and the expectations of returns related to these stocks (Cornell, 2020). There is neither consensus nor uniformity among rating agencies on how to measure stocks in terms of ESG reputation, despite using general sustainability and governance premises. Views and metrics vary, leading to a lack of a single or unanimous criterion for classifying companies according to ESG standards (Berg et al., 2022; Li & Polychronopoulos, 2020; Chatterji et al., 2016; Dorfleitner et al., 2015; Semenova & Hassel, 2015). Part of the ambiguity arises because a large number of organizations provide ESG ratings, and there is also a dispute over what should be considered within the ESG agenda in labels and ratings. The second point's debate becomes even more critical as the monetary return expectations of ESG stocks do not materialize in the long run. Some companies consider non-monetary criteria when investing in ESG stocks, making investment in stocks with ESG characteristics not necessarily tied to performance but rather to intangible aspects initially, such as reputation (Fama & French, 2007). There are behavioral biases in investors' preferences related to ESG characteristics, which affect expected returns under various circumstances depending on, among other factors, the size of the company. Information asymmetry between market agents and the lack of transparency and standardization in ESG reports contribute to volatility in these stocks' performance, and this has become characteristic of these types of investment funds. When segmenting this discussion in terms of the size of organizations, the debate becomes even more critical as smaller and medium-sized companies do not have sufficient resources to assume the risks of investing in certain types of ESG-characteristic stocks (Cornell, 2020). This discussion has so far developed only from the point of view of the utility of risk and return. This essay aims, from an ontological perspective, to understand that preferences, returns, and risks in stocks with ESG characteristics conflict in perspective in light of the objectives and even the rationality that surrounds these discussions. The essay discusses from the perspective of critical pragmatism, explanations for the dissonances in the field of ESG investment, relating the visions and rationalities that involve this discussion, and proposes, emergently, an ethos to think about preferences, returns, and risks in stocks with ESG characteristics. The theoretical contributions used start the debate on risk and returns in ESG stocks (Giese, et al., 2019; Kumar et al., 2016), discussions about the ESG agenda in finance (Friede et al., 2015), and theories related to critical pragmatism in organizations and notably in the field of finance (Serva, 2023). Just as the geometer tries to measure the circle, financial analysts create models to predict the behavior of assets and markets. However, these models are never perfect and always carry uncertainties and assumptions that may not hold true in practice. The relentless pursuit to understand and mitigate financial risks can be compared to the geometer's search for the principle of the circle. In the financial market, risk can never be completely eliminated, and risk managers must continually adapt their strategies to new information

and market conditions. Investors are constantly looking for new strategies and opportunities to maximize returns and minimize risks. Similar to Dante's geometer, they may feel frustrated when their expectations are not met or when results are not as predictable as they had hoped. Financial institutions and regulators constantly try to measure and adjust rules to ensure market stability and transparency. However, like the geometer, they often encounter new challenges and complexities that hinder the creation of a perfect system. Dante's quote underscores the complex and often unattainable nature of the search for complete understanding and control, both in geometry and in finance. It reminds professionals in the field that uncertainty is an inherent part of the domain and that the pursuit of better methods and greater understanding is a continuous and essential effort. This essay aims to shed light, from the perspective of critical pragmatism, on concepts that, when transposed to contexts carrying ethical values, must be reconsidered. The positions presented here assist in the quest for alignment of ESG rating agencies and regulation of the field to achieve an effective and substantive sustainability agenda in the finance sector, from an ethos of knowledge, even in terms of risk and return measures. This essay, building on previous studies, reflects on the need to understand that investors must commit to sustainability and accept that losses may occur. Thus, it is necessary to say goodbye to solely maximizing behavior when thinking about ESG stocks and to accept losses for the sake of future generations.

Palavras Chave
Finance risk and return, ESG agenda , Critical Pragmatism

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[...]"As the geometer who, intent to square the circle, cannot reach, through thought profound, the principle he needs, ..." [...] – Paradise, XXXIII 133-138 (Alighieri, 1998)

1 PRELIMINARY CENARY

Discussions about ESG investments have become significant within the financial field, especially concerning two aspects: (i) the divergence in standards of ESG labels and ratings and (ii) the expectations of returns related to these stocks (Cornell, 2020). Regarding the first point, it is important to note that there is neither consensus nor uniformity among rating agencies on how to measure these stocks in terms of ESG reputation, despite using general sustainability and governance premises. Views and metrics vary, leading to a lack of a single or unanimous criterion for classifying companies according to ESG (Environmental, Social, and Governance) standards (Berg *et al*., 2022; Li & Polychronopoulos, 2020; Chatterji *et al*., 2016; Dorfleitner *et al*., 2015; Semenova & Hassel, 2015). Part of the ambiguity arises because a large number of organizations provide ESG ratings, and there is also a dispute over what should be considered within the ESG agenda in labels and ratings. The second point's debate becomes even more critical as the monetary return expectations of ESG stocks do not materialize in the long run. Indeed, some companies consider non-monetary criteria, i.e., those not related to risk and return, when investing in ESG stocks, making investment in stocks with ESG characteristics not necessarily tied to performance but rather to intangible aspects initially, such as reputation (Fama & French, 2007).

It should be observed that there are behavioral biases in investors' preferences related to ESG characteristics, which affect expected returns under various circumstances depending on, among other factors, the size of the company. The problem of expected returns from investments in ESG stocks worsens when considering the different interpretations and expectations of investors. Information asymmetry between market agents and the lack of transparency and standardization in ESG reports contribute to volatility in these stocks' performance, and in this context, this has become characteristic of these types of investment funds. When segmenting this discussion in terms of the size of organizations, the debate becomes even more critical as smaller and even medium-sized companies do not have sufficient resources to assume the risks of investing in certain types of ESG-characteristic stocks (Cornell, 2020).

This discussion has so far developed only from the point of view of the utility of risk and return. This essay aims, from an ontological perspective, to understand that preferences, returns, and risks in stocks with ESG characteristics conflict in perspective in light of the objectives and even the rationality that surrounds these discussions. The essay discusses from the perspective of critical pragmatism, explanations for the dissonances in the field of ESG investment, relating the visions and rationalities that involve this discussion, and proposes, emergently, an ethos to think about preferences, returns, and risks in stocks with ESG characteristics. The theoretical contributions used start the debate on risk and returns in ESG stocks (Giese, *et al*, 2019; Kumar *et al*., 2016), discussions about the ESG agenda in finance (Friede *et al*., 2015), and theories related to critical pragmatism in organizations and notably in the field of finance (Serva, 2023).

2 The Dialogue Between Risk-Return and ESG Preferences

Risk and future returns are essential elements to consider when investing in specific stock portfolios. In finance, "risk" generally refers to the uncertainty surrounding the future returns of an investment, whether it pertains to market price fluctuations, such as in stocks, interest rates, and foreign exchange, or to the possibility of a borrower failing to meet their financial obligations. It also includes the inability to buy or sell assets quickly without significantly impacting the price, potential losses from failures in internal processes or systems or due to external events, and changes in laws or regulations that may affect the operations or profitability of a company. Furthermore, there is the possibility of an event or condition causing cascading failures in the financial system, impacting numerous institutions simultaneously. Thus, understanding and perceiving risk is crucial for the utility function, and it is important to note that the variables to be observed also expand as society delegates the role of organizations in socio-environmental governance, particularly in recent decades (Berg *et al.*, 2022; Li & Polychronopoulos, 2020; Chatterji *et al.*, 2016; Dorfleitner *et al.*, 2015; Semenova & Hassel, 2015).

Observing the trajectory of these discussions, it is apparent that although the agenda was initially propelled by corporate pacts with multilateral agencies from a programmatic perspective, it is not surprising that discussions about risk and return for these ESG investments would eventually be undertaken. In finance, the return (or yield) is the measure of gain or loss generated by an investment over a period. This return is generally expressed as a percentage of the initial investment. It may include both the appreciation (or depreciation) of the asset's value and any income received, such as dividends or interest. There are various ways to calculate and express return, depending on the context and the type of investment where capital is allocated (Fama & French, 2007; Friede *et al.*, 2015).

According to Cornell (2020), investing in stocks that adhere to ESG criteria (Environmental, Social, and Governance) can offer competitive returns compared to traditional investments, in addition to generating positive impacts on the environment and society. Research indicates that companies with robust ESG practices often exhibit better risk management and greater resilience, which can result in more attractive risk-adjusted returns over time. Furthermore, with the increasing demand for sustainable investments, driven by a growing awareness among investors and stricter regulations, the returns on ESG stocks may benefit from additional capital flows and a more positive market valuation. Therefore, when evaluating returns, investments in ESG stocks seek not only financial gains but also to align investors' interests with sustainability and social responsibility goals.

What defines balance and ESG preferences is due to various factors that extend beyond the utility function; however, they tend not to stray from it in terms of risk and return. Gollier and Pouget (2014) suggest that major investors can potentially follow a "washing machine" strategy by establishing a significant position in companies with low ESG criteria. By actively engaging with the aim of inducing management to change its practices and become more eco-friendly, and if successful, and if this success leads to a drop in the discount rate because the company has become more eco-friendly, they can sell the shares at a profit, meaning the risk and return function are calculated. However, according to Cornell (2020), the risk-return relationship is impacted by the limitation of portfolio diversification from the ESG criterion; if ESG criteria follow strict restrictions, they result in a negative impact on the performance of investments compared to unrestricted investment portfolios since an unrestricted investor can always opt to maintain a portfolio with ESG restrictions, but the reverse is not true.

In this regard, Fama and French (2007) demonstrated that when the utility functions of at least some investors include variables beyond future consumption, prices deviate from the standard predictions of conventional risk and return models. Thus, if a subset of investors prefers to invest in green companies, the expected return from investing in greener companies will be lower. Pastor *et al*. (2020) support these findings, indicating that if investors prefer green companies, the expected risk-adjusted returns of these companies will be lower in equilibrium. Considering the above, from a pragmatic viewpoint, studies have shown that a shift in perspective in the risk-return relationship should occur as preferences in ESG stocks are broadened, and this change involves consciously assuming the risks of losing capital for other rationalities beyond the utilitarian, which simply seeks to capitalize on a growing trend or reduce reputational cost. Therefore, from a critical pragmatic perspective, a change in culture in the management of funds with a positive preference for ESG stocks should commit to sustainability and accept that losses may occur. Thus, it is necessary to say goodbye to the solely maximizing behavior when considering ESG stocks. The following section will address how a pragmatic and critical view can assist in aligning an ethos for the construction of a common agenda of preferences in ESG.

3 From Rhetoric to Critical Pragmatism on ESG Investment Labels

The literature on pragmatism undeniably focuses on the practical utility of ideas and the importance of experience and action in the formation of knowledge and science. However, critical pragmatism aligns with this view by including self-examination and criticism of its own assumptions and implications, including an analysis of power structures and social and historical contexts (Denzin, 2010; Dewey, 1998; Serva, 2023; Taupin, 2015; Sennet, 1998). It offers an interdisciplinary perspective, employing methods and perspectives from various disciplines to address complex problems substantively and contextually. From its inception, pragmatism adopted the perspective of transformative action in favor of social justice, which can be transposed to the pragmatic agenda of sustainability in finance, acknowledging the ontological inconsistencies between the risk-return relationship from the purely utilitarian viewpoint to the detriment of substance.

Critical pragmatism, on the other hand, introduces a reflective and self-critical dimension to this approach. It not only considers the practical effects of ideas but also critically questions and analyzes the assumptions, contexts, and powers underlying these effects (Serva, 2023). Key figures associated with critical pragmatism include using methods and perspectives from various disciplines to address complex problems in a holistic and contextualized manner, an interest in the social and political implications of ideas, with an emphasis on promoting social justice and the common good, and recognizing the need to adapt ideas and theories based on new information, contexts, and emerging challenges. Critical pragmatism, therefore, represents an evolution of traditional pragmatism, adding a layer of criticism and self-reflection that seeks not only to apply ideas practically but also to understand and question the forces that shape these ideas and their consequences (Serva, 2023).

This relation reflects a tension between immediate practical application and a deeper critical reflection on the social and ethical implications of discursive practices, and this indeed relates to fund management, with the various scales of ratings and labels in ESG. Critical pragmatism will point to a reality: it is necessary to assume losses for the sake of something greater, promoting sustainability for the survival of future generations, i.e., a socio-environmental dimension of ESG preferences needs to be consciously assumed. Although pluralistic and without consensus, this debate requires ontological alignments with the ESG agenda. From here, a critically pragmatic analysis of the relationships between risk, return, and ESG actions is proposed to guide an ethos of ontological alignment with the sustainability agenda, beyond mere compliance. This proposal is based on studies of pragmatism in organizations, notably the studies of Serva (2023). The author proposes a shift in positioning related to self-reflection on the role of organizations, which will be transposed to the field of finance, ESG preferences, and their classifications in terms of ratings and labels.

The first position implies conceiving the field of finance as a collective action. Such a position encourages dialogue between actors, especially those involved in managing ESG funds and rating agencies. Serva (2023) points out that this position focuses on collective action characterized by two dimensions: regularity (duration and relative institutionalization) and, mainly, the intensity of regulation that actors implement in their transactions. For critical pragmatism, regulation is a way of addressing conflicts and their effects and changing and practicing collective engagements for action. Therefore, the current diversity and dissonance in classifications need to identify a consensus to achieve real and substantive alignment with the ESG agenda. This alignment requires dialogue with field scholars, various actors, and the rating agencies themselves.

The second position refers to the conception of fund management. Serva (2023) reflects that organizations and management are conceived as contiguous dimensions of collective action. Considering action as the core of the analysis, organizations and management have as their background the same phenomenon: collective action. Even in the case of fund management, this collective is specific; there is a collective that aims to communicate with other spheres of the organization and society. As the regularity of debate and, especially, regulatory efforts become progressively prominent in a given collective action, involving more energy and time from the actors, fund management actions can gain increasing importance for the actors themselves and the field of finance and ESG research. From a critical pragmatic perspective, the field of finance and ESG has demonstrated a certain indeterminacy of situations, exacerbated by the deepening crisis of multifaceted classifications and risk-return expectations, often not focused on the long term but on short-term rewards.

The third position poses a challenge as it leads to the elimination of previous theoretical models for risk and return analysis. The pragmatic analysis seeks to capture what emerges from the action under study. The ontological study of sustainability requires self-reflection on the contributions used to think about sustainability and even the risk and return of these actions. Throughout the investigation, reflecting on the data, the researcher identifies useful and useless theories and concepts for the analysis. Serva (2023) points out that research often starts with experimentalist processes, adopting a prior analysis model that proves inefficient. This is the case with the conception of return solely from a utilitarian perspective, which does not allow for the assumption of the uncertainty of the ESG agenda and requires openness to what emerges from the experimentalist investigation of researchers dedicated to thinking about the challenges of investing in such actions. If studies have indicated that there is no long-term return, it is necessary to rethink the notion of return to accommodate other long-term visions.

The fourth position deals with the integration of levels of analysis, which, according to Serva (2023), requires overcoming the formation of scientists in the field of organizational studies. This study acknowledges the difficulties, among other factors, of the formation of scientists in the field of finance. Traditionally, according to the author, studies in Administration, including Finance studies, have placed analysis exclusively at the macrosocial level, influenced by economics and previous deterministic models, or at the meso level — composed of organizations — or in the macro-meso and micro-meso binaries. Macro-meso-micro integration is rare as it requires the intertwining of theories and experiments, which in the field of finance needs to move away from an exclusively positivist accommodation of studies and towards more counter-hegemonic analysis that, for example, ESG preferences have been demanding. For Serva (2023), this integration represents a long-term goal in the pragmatic analysis of organizations, recognizing that there is still a long way to go for its full realization.

Cornell (2020) points out that investors trying to improve performance by tilting their portfolios towards companies with high ESG ratings are likely to be disappointed, as they are not oriented to the ontology of the agenda but rather to a search for maximization of returns and reputation. The author also indicates that there is no consensus on the existence of an ESG risk factor because there is no consensus on ESG classifications, and the sample period available, on which there are ESG data, is short. However, even if studies have very recent samples, it becomes evident that: the growing focus on ESG in investments may well bring social benefits and incentives that lead to lower equity capital costs, but such trade-offs come with a cost in the form of lower expected returns for investors. Pragmatically, it is necessary to assume the loss in favor of another type of return.

4 EMERGING CONSIDERATIONS

The quote at the beginning of the text, taken from Dante Alighieri's work "The Divine Comedy" is not by chance. Those of us who study organizations, the sustainability agenda, and the field of finance are often challenged to understand and provide predictability to the movements of the financial market. Just as the geometer in Dante's passage seeks to understand a circle in its perfection by dividing the circumference by the diameter of a circle but cannot find its exact end, as it involves the number pi, finance professionals frequently face difficulties when trying to predict market movements or find the perfect formula for financial success, especially when uncertainty permeates fund management and stock preferences. The quote reflects the complex and sometimes elusive nature of financial markets, where the quest for a complete and perfect understanding can be a continuous effort with no guarantee of absolute success.

Just as the geometer tries to measure the circle, financial analysts create models to predict the behavior of assets and markets. However, these models are never perfect and always carry uncertainties and assumptions that may not hold true in practice. The relentless pursuit to understand and mitigate financial risks can be compared to the geometer's search for the principle of the circle. In the financial market, risk can never be completely eliminated, and risk managers must continually adapt their strategies to new information and market conditions. Investors are constantly looking for new strategies and opportunities to maximize returns and minimize risks. Similar to Dante's geometer, they may feel frustrated when their expectations are not met or when results are not as predictable as they had hoped. Financial institutions and regulators constantly try to measure and adjust rules to ensure market stability and transparency. However, like the geometer, they often encounter new challenges and complexities that hinder the creation of a perfect system.

Dante's quote underscores the complex and often unattainable nature of the search for complete understanding and control, both in geometry and in finance. It reminds professionals in the field that uncertainty is an inherent part of the domain and that the pursuit of better methods and greater understanding is a continuous and essential effort. This essay aims to shed light, from the perspective of critical pragmatism, on concepts that, when transposed to contexts carrying ethical values, must be reconsidered. The positions presented here assist in the quest for alignment of ESG rating agencies and regulation of the field to achieve an effective and substantive sustainability agenda in the finance sector, from an ethos of knowledge, even in terms of risk and return measures. This essay, building on previous studies, reflects on the need to understand that investors must commit to sustainability and accept that losses may occur. Thus, it is necessary to say goodbye to solely maximizing behavior when thinking about ESG stocks and to accept losses for the sake of future generations.

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