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From Exogenous Incentives to Endogenous Dynamics: The Core Dilemma of ESG Development in China

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Abstract. Under the background of global ESG standardization, the development of ESG in China illustrates a significant "quantity-quality divergence" feature, which is shown as insufficient disclosure of quantitative data and a decline in the issuance volume of green investment products. By comparing the transnational systems of Germany and France with the case studies of Baosteel and CATL, it examines the path and conditions to solve the problem of "high compliance and low internalization". Research findings show that policy pressure is necessary but not sufficient, which promotes rapid popularization but fails to stimulate deep internalization. Instead, market pressure is more effective, indicating the importance of transmitting ESG performance to a company's competitiveness, which requires the coordinated efforts of systems, markets and enterprises.

Keywords: Sustainable Development, ESG, China, Policy-Driven, Self-Driven

1. Introduction

Sustainable development and ESG have become core issues in the global financial market [1]. The GSIA 2022 report recorded $35.3 trillion in sustainable investment assets in major markets, accounting for 35.9% of the total professionally managed assets [2]. Some people believe that sustainable development is an irreversible global trend [3], and there is still huge room for development for China, while some members of the public and practitioners still have a limited understanding of sustainable investment and even question the practical significance of ESG.

Compared with mature regions, like London, ESG practices in China are still in their infancy and show significant policy-driven characteristics. That is, ESG practices of enterprises primarily stem from regulatory requirements rather than being endogenous to their strategic identity and operations [4]. Here, this predicament is conceptualized as a transformation from "Exogenous Incentives" to "Endogenous Dynamics". Exogenous incentives refer to institutional pressure originating from outside the enterprise [5]; endogenous drivers refer to the process by which enterprises internalize ESG as a strategic identity and value pursuit [6]. The "Internalization Gap" between the two constitutes one of the core obstacles to the development of ESG in China.

The study examines the constraints and conditions under which China can transform policy-driven ESG into spontaneous practices, thereby enabling more people to recognize the long-term value of ESG and providing a theoretical basis and empirical support for the evolution of China's ESG.

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2. Methodology

The study adopts a research design that combines macro and micro perspectives.

2.1. Macro perspective: country case analysis

At the macro level, the research employs comparative analysis of systems and selects two countries, Germany and France, for case comparisons with China. All three countries share distinct features of coordinated national economies but exhibit different institutional logics in their ESG development paths. Germany, based on a social market economy, relies on the "energy transition" policy to promote green transformation. France leads the development of ESG through a state-led green finance strategy. China, with the policy-driven "dual carbon" goals, demonstrates a strong feature of national mobilization. Case selection is based on four criteria: ESG development maturity, institutional comparability, clarity of transformation paths, and data availability, aiming to identify the key mechanisms for ESG internalization in different institutional environments.

2.2. Micro perspective: enterprise case comparison

At the micro level, the study adopts a comparative case study based on the two dimensions of "policy exposure" and "internalization signs", two A-share listed companies with the most comparative relevance are selected from the theoretical sampling matrix for in-depth analysis. Case A is Baosteel (SOE), representing a compliance-oriented approach under high policy pressure. Case C is CATL (export-oriented private enterprise), representing an internalization path driven by international market pressure. The analysis focuses on three dimensions: (1) The evolution trajectory of ESG practices; (2) Is the enterprise's behavior a policy response or an autonomous action? (3) Identification of key turning points.

3. Discussion on China's ESG development status and transformation path

3.1. Current state of ESG development in China

Currently, the development of ESG in China shows a significant feature of "quantity-quality divergence". From the quantitative perspective, the ESG report disclosure rate of A-shares has reached over 40% in September 2024 (2,220 companies), an increase of 7% compared to the previous year. The number of PRI signatories has increased from 43 in 2020 to 128 in 2024 [7]. The balance of green credit climbed to 35.75 trillion yuan [8].

However, the increase in the number of disclosures has not translated into an improvement in quality. Although 66.56% of enterprises make qualitative disclosures of climate information, less than half (32.61%) provide quantified carbon emission data [9]. In addition, the issuance volume of green investment products in 2024 decreased by 3.1% year-on-year, and the adoption rate of negative screening lists dropped by 9.1%, forming a trend of "expanding disclosure but shrinking investment" [7]. In terms of rating distribution, the number of B+ rated companies has increased tenfold over the past six years, while those rated below C+ have decreased by 92%. But, AA and AAA ratings remain scarce, indicating that although policy pressure has eliminated tail-end enterprises, it is difficult to motivate outstanding performance [9]. At the governance level, approximately 79% of the CSI 300 companies have established ESG committees, but most are limited to compliance reviews and have not been truly integrated into strategic decision-making [10].

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In conclusion, China's ESG is characterized by "policy-driven dominance", "weak market mechanisms" and "insufficient internalization by enterprises", which constitute the core obstacle to the transformation from exogenous drive to endogenous power.

3.2. The possibility of transition

Can China's ESG shift from policy-driven to internalized in the market? Cross-border comparisons and enterprise cases provide important insights.

Table.1 Common elements of the transformation paths of Germany and France

Factor	Germany: Energy Transition	France: Green Finance Leadership
Institutional pressure	2010–present, multi-government continuity	2015–present, progressive regulatory expansion
Market incentive	Feed-in tariffs, grid investment, R&D funding	Mandatory investor disclosure, sovereign green bond benchmark
Corporate capability building	Industrial policy support, technology partnerships	Financial sector expertise development, green bond market infrastructure
Stakeholder governance	Social partnership, codetermination	State-led coordination with industry consultation

Source: GSIA, 2022. Global sustainable investment review 2022 [2]

As shown in Table 1, from the transformation experiences of Germany and France, the successful path includes three common elements: continuous institutional pressure, effective market incentive creation, and the supporting measures for enterprise capacity building [2].

However, China is facing unique institutional constraints. For instance, campaign-style governance leads to unstable policy expectations; the coverage of semi-mandatory disclosure is lower than that of the comprehensive mandatory system in Europe; the ESG-capital cost transmission mechanism is weak; and corporate capabilities are concentrated in large state-owned enterprises and international companies, making it difficult to spread broader [8].

Table.2 Comparison of Chinese enterprise cases

Dimension	Case A: Baosteel	Case C: CATL
Ownership	Central SOE	Private (export-oriented)
Primary ESG driver	Domestic policy pressure	International market access requirements
Policy exposure	Very high (carbon-intensive, strategic industry)	Moderate (favored sector, less direct regulation)
MSCI rating	BBB → AA(2019–2023)	B → AA(2019–2023)
Rating-timing relationship	Followed policy requirements	Preceded and enabled global market leadership
Strategic integration	Governance structures, executive compensation	ESG-driven product development, supply chain requirements, competitive positioning
Zero-carbon commitment	2050 industry-neutral target	2025 core operations, 2035 value chain
Operational achievement	Progress toward targets	74.51% renewable electricity, 9 zero-carbon factories

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Source: MSCI 2024 [11]; Baosteel ESG Report 2024 [12]; CATL Sustainability Report 2024 [13]

Turning to table 2, the comparison of Chinese enterprise cases further reveals the micro-mechanism of transformation. As a highly polluting state-owned enterprise, Baosteel is under extremely high policy pressure (the steel industry accounts for approximately 15% of the country's carbon emissions). It has achieved an upgrade in its ESG rating, but its strategic integration is still oriented towards compliance, emphasizing policy response rather than competitive differentiation [12]. CATL is under relatively low policy pressure, but international market demands (EU battery regulations, customer ESG audits) have driven its ESG rating to the highest level in the industry, and it has taken the lead in setting goals that exceed compliance [13].

Based on the above comparison, policy pressure is a necessary but not sufficient condition. It effectively promotes the popularization of ESG and bottom-line compliance, but is difficult to stimulate deep internalization. International market pressure, a complex of regulatory pressure and economic incentives, is more effective as it directly links ESG performance to a company's market access and competitive position, creating a positive cycle. This also confirms the core insight of institutional theory [6]: when external pressure is strongly associated with an organization's strategic interests, the organization is more likely to go beyond "silent compliance" and move towards true strategic integration.

3.3. Conditions and recommendations for successful transition

Based on the case study analysis above, for ESG to transform into an endogenous driving force, it is necessary to build a collaborative mechanism at the institutional, market, and enterprise levels.

At the institutional level, it is crucial to shift from "campaign-style governance" to "capacity empowerment". Germany's experience in energy transition shows that the key to policy success does not lie in the intensity of coercion, but in the combination of continuous institutional pressure and supporting capacity building, such as technical assistance, industry standards and other support systems [2]. This way, China could consider establishing a predictable long-term policy framework, gradually extending the semi-mandatory disclosure requirements of stock exchanges to full market coverage, with a 3-to-5-year transition period. In terms of capacity building, industry-specific ESG management guidelines or tools can be developed through industrial associations (such as the China Iron and Steel Association) to address the capability bottleneck of small and medium-sized enterprises that lack the expertise to implement ESG effectively.

At the market level, the core lies in unblocking the transmission chain from "ESG performance" to "capital cost". Although the current scale of green finance is large, the effective correlation between ESG ratings and financing pricing, insurance premiums, and valuation premiums has not yet been formed [7]. China could consider substantially incorporating ESG into the fiduciary responsibilities of institutional investors, encouraging credit rating agencies to explicitly integrate ESG factors, or promoting sustainability-linked financial products. For instance, encouraging domestic credit rating agencies to integrate ESG factors into their methodologies, enabling high-scoring ESG enterprises to gain an advantage in terms of financing costs. Only when "top students" receive real market returns in cash, can enterprises view ESG as competitiveness rather than cost.

At the enterprise level, the key lies in the embedding of ESG materiality in governance. From the perspective of enterprise cases A and C, there are many signs of deep internalization, such as ESG entering the board's decision-making agenda, being linked to capital allocation, and having a weight of over 20% in executive compensation, etc. This requires enterprises to go beyond the formal compliance of "disclosing reports" and "establishing committees", and truly integrate ESG

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indicators into the core processes of strategy and investment. For instance, transferring ESG from the compliance department to the strategic core would enable the ESG committee to have substantive decision-making power rather than advisory functions. Or enterprises could draw on CATL's 100% audit coverage and certification requirements for suppliers and extend ESG standards to the access conditions of the supply chain.

4. Conclusion

The study examines the path and conditions for the transformation of China's ESG development. Through cross-border comparisons and case analysis, it reveals the interaction between policies and market mechanisms in the internalization process of ESG in enterprises, providing empirical evidence in the Chinese context for institutional theories. First, policy pressure is a necessary but not sufficient condition. Second, market incentives are more effective for internalization. The comparison between Baosteel and CATL reveals that international market pressure directly links ESG performance with enterprises' competitive advantages, forming a positive cycle from "ESG performance" to "competitive advantage" and then to "internal driving force", and its effect far exceeds that of a single policy pressure. Thirdly, a successful transformation requires the coordinated efforts of systems, markets and enterprises. Policies need to shift towards capacity building, the market needs to establish a transmission mechanism from ESG ratings to capital costs, and enterprises need to substantially embed ESG into strategic decisions and executive incentives.

In terms of the limitations of the above conclusion, the number of cases studied is small, and the data mainly relies on public disclosure, failing to delve into the internal decision-making process of enterprises. In addition, the long-term effects of international market pressure still need to be tracked and verified. Future research could expand the sample size, adopt a mixed-methods approach to examine the differentiated transformation paths of enterprises across different industries and ownership types, and focus on the gradual development of domestic ESG market mechanisms.

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