

The Impact of Cognitive Empathy on ESG Investment Decision-Making

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Received: 15 December 2024 | Accepted: 13 January 2025 | Published: 1 March 2025

DOI: <https://doi.org/10.55057/ijaref.2025.7.1.6>

Abstract: *This paper examines the influence of two dimensions of cognitive empathy—perspective-taking and fantasy—on decision-making in Environmental, Social, and Governance (ESG) investments. The findings reveal that perspective-taking enables investors to adopt the viewpoints of those impacted by social or environmental challenges, thereby enhancing their sense of social responsibility and reinforcing their awareness of long-term returns. This drives them to prioritise projects that deliver social and environmental benefits. Fantasy, on the other hand, facilitates scenario simulation, allowing investors to gain a more intuitive understanding of the long-term social and environmental value of ESG projects. This enhances social value alignment, boosts confidence in long-term returns, and fosters the exploration of innovative investment strategies. Furthermore, the abilities of perspective-taking and fantasy assist investors in balancing economic returns with social value, thus promoting the advancement of ESG investments. However, excessive reliance on these abilities may lead investors to overlook short-term returns or economic feasibility. Future research could delve deeper into the underlying mechanisms of cognitive empathy in investment decision-making and develop strategies for optimising its application, offering theoretical support and practical guidance for the sustainable development of ESG investments.*

Keywords: Perspective-Taking, Fantasy, Cognitive Empathy, ESG Investment, Decision-Making Behaviour

1. Introduction

Cognitive empathy refers to an individual's ability to understand others' perspectives and feelings by relying on logic and reasoning to analyse their mental states (Davis, 1983). Unlike affective empathy, it emphasises rational inference rather than direct emotional responses to build understanding of others, making it particularly crucial in complex social interactions and decision-making contexts. Research indicates that cognitive empathy can significantly enhance individuals' ability to balance diverse interests and improve decision quality, thereby playing a vital role in fostering better social relationships and strengthening cooperation (Batson, 1997).

The study by Ruedy and Schweitzer (2010) demonstrates that cognitive empathy substantially enhances moral judgement, prompting individuals to prioritise social responsibility and long-term benefits in complex decision-making scenarios. This capability not only helps individuals more effectively evaluate the consequences of social actions but also encourages them to comprehensively consider the interests and needs of others during decision-making (Ruedy &

Schweitzer, 2010). In the context of decision sciences, cognitive empathy is regarded as a mechanism for balancing short-term and long-term interests, thereby optimising decision quality in complex situations (Amel-Zadeh & Serafeim, 2018). Through cognitive empathy, individuals can use logical analysis and scenario simulation to more accurately predict the potential consequences of their actions and identify equilibrium points among conflicting interests—a skill particularly critical in complex decision-making domains such as Environmental, Social, and Governance (ESG) investments.

The core components of cognitive empathy include perspective-taking and fantasy, which together provide multidimensional cognitive support, enabling individuals to make more comprehensive and sustainable decisions based on rationality and logic, with minimal influence from emotions. In ESG investment contexts, cognitive empathy aids investors in evaluating complex ESG factors, facilitating the integration of short-term financial goals with long-term social value to optimise decision quality (Amel-Zadeh & Serafeim, 2018; Upadhyay, 2024). This ability allows investors to approach the trade-offs between economic returns and social value in a more comprehensive and rational manner, driving resources towards areas with greater sustainable development potential. Amel-Zadeh and Serafeim (2018) highlight that investment strategies integrating ESG considerations not only significantly improve risk-adjusted portfolio returns but also enhance investors' awareness of social responsibility, further reinforcing the practical value of ESG investments.

2. The Concept and Theoretical Framework of Perspective-Taking and Fantasy

2.1 The Concept and Theoretical Framework of Perspective-Taking

Perspective-taking refers to an individual's deliberate effort to analyse problems from others' viewpoints, gaining an understanding of their circumstances and needs to comprehensively evaluate the multifaceted impacts of an event. Batson (1997) argues that perspective-taking enhances an individual's awareness of others' needs and fosters fair and responsible actions in contexts involving multiple stakeholders (Batson, 1997). Additionally, perspective-taking has been shown to improve moral judgement, encouraging greater attention to social responsibility and long-term benefits in decision-making (Ruedy & Schweitzer, 2010).

Social Cognitive Theory provides a robust framework for explaining the role of perspective-taking in decision-making. According to this theory, individuals can observe others' behaviours, infer social contexts, and simulate potential scenarios to predict the consequences of actions and make informed decisions (Bandura, 1986). This theory highlights how humans integrate environmental information through cognitive processes to formulate rational and socially responsible behavioural decisions. Perspective-taking not only enhances an individual's sense of social responsibility but also improves the quality of investment decisions. Amel-Zadeh and Serafeim (2018), through a global survey, found that investors with high perspective-taking ability were better equipped to identify the potential long-term value of ESG factors, enabling them to adjust investment strategies to balance financial returns and social benefits (Amel-Zadeh & Serafeim, 2018).

Social Cognitive Theory offers theoretical support for understanding how perspective-taking influences decision-making in ESG investments. By enhancing investors' awareness of social and environmental issues and promoting a comprehensive consideration of multiple interests, perspective-taking drives resources towards projects with higher sustainable development potential. This, in turn, facilitates a balance between economic returns and social value.

2.2 The Concept and Theoretical Framework of Fantasy

Fantasy refers to the ability of individuals to place themselves imaginatively into the experiences or situations of others in a creative manner. This capability not only aids individuals in understanding others' feelings and needs but also supports complex social and economic decision-making by simulating potential future scenarios and outcomes (Davis, 1983). A defining characteristic of fantasy is its reliance not only on emotional resonance but also on cognitive reasoning, enabling individuals to develop an intuitive perception of social contexts and their potential future changes.

The theoretical framework of fantasy can be explained through various models. The scenario simulation theory provides a fundamental basis for understanding the function of fantasy. According to this theory, individuals construct future scenarios in their minds and imagine the potential outcomes of these scenarios, thereby motivating decision-making (Taylor & Schneider, 1989). This process not only allows individuals to perceive future possibilities but also strengthens their awareness of long-term goals, encouraging them to take action to achieve these objectives. Fantasy can also be further elucidated through social cognitive theory. As Bandura (1986) suggests, an individual's behaviour is driven not only by external environmental factors but also by internal cognitive processes, with fantasy serving as a core component of these processes. By simulating the social and environmental outcomes of various scenarios, fantasy enables individuals to anticipate the potential impacts of their actions, thereby balancing short-term gains with long-term social value in their decision-making. This mechanism is particularly critical in complex decision-making contexts, as it enhances individuals' tolerance for future uncertainties and stimulates behavioural motivation.

The close relationship between fantasy and altruistic behaviour, as well as social responsibility, has been corroborated by numerous studies. In Davis's (1983) multidimensional empathy scale, fantasy was found to be significantly associated with individuals' altruistic tendencies and social responsibility awareness. Batson (1997) argued that fantasy enhances individuals' perception of others' needs, leading them to favour actions with social value in complex, multi-stakeholder contexts. This ability is particularly relevant to ESG investments, where the benefits of many projects are often long-term and indirect.

3. The Impact of Perspective-Taking on ESG Investment Decision-Making

Perspective-taking, a key component of cognitive empathy, profoundly influences ESG investment behaviour by enabling investors to understand others' viewpoints and needs. In ESG investing, perspective-taking provides investors with a multidimensional analytical framework, allowing them to strike a better balance between economic returns and social value. This section explores the specific roles of perspective-taking in ESG investment from the perspectives of enhancing social responsibility and recognising long-term returns.

3.1 Enhancing Social Responsibility

Perspective-taking significantly enhances investors' perception and recognition of social responsibility. By adopting others' viewpoints, investors can gain a deeper understanding of how social and environmental issues impact different groups, thereby improving their comprehension of social responsibility. Research by Ruedy and Schweitzer (2010) demonstrates that perspective-taking significantly promotes moral judgement and social responsibility, aligning investors' decisions with behaviours that contribute to societal improvement—an alignment consistent with the core principles of ESG investing (Ruedy & Schweitzer, 2010). Iazzolino et al. (2023) highlight that sensitivity to ESG factors varies across

industries, and perspective-taking enables investors to more effectively identify businesses and projects with high social responsibility value, thereby optimising their investment decisions. Perspective-taking not only helps investors understand the direct impact of ESG projects but also facilitates the identification of their potential long-term social and environmental benefits. Investors with strong perspective-taking abilities tend to support long-term projects that, while offering lower short-term returns, address environmental issues or promote social equity, thus achieving sustainable development (Upadhyay, 2024). Furthermore, perspective-taking enhances investors' sensitivity to stakeholders' needs in complex investment environments, enabling a comprehensive assessment of ESG projects' impacts on businesses, communities, and policies. This capability is critical to the successful implementation of ESG projects (Aich et al., 2021).

By improving investors' perception and recognition of social responsibility, perspective-taking helps them identify the long-term social and economic benefits of ESG projects. This cognitive mechanism allows investors to comprehensively evaluate the potential value of investment projects, providing essential support for balancing economic and social objectives.

3.2 Strengthening Recognition of Long-Term Returns

When faced with complex investment choices, perspective-taking allows investors to move beyond the constraints of short-term financial returns and focus on the social and environmental impacts of projects. Perspective-taking significantly enhances individuals' moral judgement and social responsibility, making investors with strong perspective-taking abilities more likely to incorporate long-term social benefits into their decision-making criteria (Batson, 1997). By fostering deeper understanding, perspective-taking encourages individuals to exhibit greater moral sensitivity when weighing diverse interests, thereby supporting sustainable development-related actions with greater resolve (Ruedy & Schweitzer, 2010). This ability is particularly vital in ESG investing, as it helps investors comprehensively evaluate the potential long-term benefits of ESG projects, strengthening their willingness to support social and environmental gains.

Upadhyay (2024) found that integrating ESG factors into investment strategies significantly improves portfolio stability and enhances the potential for long-term returns. This improved stability and return potential largely rely on investors' ability to deeply understand ESG projects through perspective-taking. Perspective-taking aids investors in better understanding systemic risks and externalities when evaluating long-term projects, as ESG factors exhibit industry-specific differences. Investors must adopt a systemic view to analyse the sources of long-term returns, which often necessitates perspective-taking—particularly in addressing environmental complexities and social inequalities (Iazzolino et al., 2023). Studies also reveal that perspective-taking enhances investors' confidence in long-term and indirect returns. Amel-Zadeh and Serafeim (2018) note that the economic benefits of many ESG projects require extended periods to materialise. Perspective-taking enables investors to simulate the cumulative process of these benefits, making them more inclined to support such projects. This cognitive approach aligns closely with the long-term perspective of ESG investments, providing investors with stronger psychological motivation. Perspective-taking also helps investors balance short-term volatility with long-term stability. Research by Aich et al. (2021) demonstrates that investors with strong perspective-taking abilities can better understand how ESG projects retain long-term growth potential despite short-term uncertainties, allowing them to maintain stable investment behaviours during market fluctuations.

In summary, perspective-taking enhances investors' understanding of the long-term benefits of ESG projects, enabling them to prioritise projects with enduring value in their decision-making. This ability not only improves portfolio stability but also strengthens investors' support for sustainable development initiatives, thereby promoting the alignment of social value and economic benefits.

4.The Impact of Fantasy on ESG Investment Decision-Making

Fantasy, as a core dimension of cognitive empathy, influences investment decisions by enabling investors to intuitively comprehend the social and environmental changes that ESG projects might bring through scenario imagination. Unlike perspective-taking, fantasy relies more heavily on constructing and simulating future scenarios, allowing investors to appreciate the significance of ESG investments in terms of long-term and indirect economic returns.

Fantasy enhances investors' ability to imagine future scenarios, helping them intuitively grasp the potential social and environmental benefits of ESG projects. Davis (1983) identified a significant positive correlation between fantasy ability and altruistic behaviour, indicating that fantasy not only strengthens individuals' sense of social responsibility but also motivates action in investment decisions. Research by Verhaert and Poel (2011) further supports this, showing that individuals with higher fantasy abilities demonstrate stronger willingness to engage in complex decision-making, highlighting the potential of fantasy to promote ESG investment behaviour.

4.1 Stimulating Social Value Alignment

Fantasy helps investors imagine the potential social and environmental benefits of ESG projects through scenario simulation, fostering a sense of alignment with social values. This sense of alignment encourages investors to prioritise projects capable of delivering positive social impacts in their decision-making. Fantasy moves investors beyond a narrow focus on financial returns, enhancing their sensitivity to non-financial value, making it a key psychological driver of ESG investment. Aich et al. (2021) found that investors with high fantasy abilities tend to favour companies with higher ESG ratings, as these companies exhibit stronger sustainability in social responsibility and environmental governance. This ability helps investors recognise the potential of ESG projects to improve social welfare, protect the environment, and contribute to global Sustainable Development Goals (SDGs), thereby prioritising support for such initiatives. Fantasy allows investors to intuitively perceive the long-term social returns of ESG projects, rather than limiting their assessment to short-term economic gains. As ESG factors significantly influence corporate long-term efficiency and sustainability, fantasy enables investors to simulate these potential long-term benefits, reinforcing their recognition of project value (Iazzolino et al., 2023).

Fantasy also drives investors to explore innovative investment areas. Through scenario simulation, investors can anticipate revolutionary solutions to global environmental challenges driven by emerging technologies, making them more inclined to support projects with high potential impact. Investors with strong fantasy abilities exhibit greater willingness to support innovative ESG projects, as they can visualise the far-reaching effects these initiatives might produce through scenario simulation (Upadhyay, 2024). Fantasy not only helps investors understand the social value of projects but also increases their acceptance of non-financial returns. Amel-Zadeh and Serafeim (2018) note that many ESG projects' benefits are often indirect or long-term, and fantasy enables investors to concretise these potential gains, thereby boosting their confidence in ESG investments.

In summary, fantasy helps investors recognise and perceive the potential social and environmental value of ESG projects through scenario simulation, enhancing their support for such initiatives. This ability not only strengthens investors' confidence in long-term social returns but also drives exploration of innovative sustainable investment, further promoting the adoption and optimisation of ESG investments.

4.2 Driving Innovative Investment Strategies

Fantasy enables investors to develop innovative investment strategies through scenario simulation, helping them better adapt to the dynamic nature of the ESG investment field. This ability allows investors to step outside traditional investment frameworks, adopting a more forward-looking perspective to identify emerging trends and opportunities in ESG markets.

Upadhyay (2024) found that investors with strong fantasy abilities are more willing to explore innovative investment strategies that integrate ESG factors. While these areas may involve greater uncertainty, they hold disruptive potential to play pivotal roles in global sustainable development. This capability not only enhances the depth of investors' decision-making but also supports the diversification of the ESG investment market.

Fantasy also enhances investors' adaptability to rapid changes in ESG markets. The dynamic nature of ESG investments requires investors to identify potential value in emerging areas, and fantasy strengthens their acuity through scenario construction, enabling them to anticipate opportunities arising from policy changes, technological breakthroughs, or shifting societal demands (Iazzolino et al., 2023). This forward-looking perspective equips investors to better identify and seize opportunities, driving innovation and growth in ESG investments.

In conclusion, fantasy supports the innovation and diversification of ESG investments by fostering scenario simulation, enhancing foresight, and promoting cross-domain integration. This ability enables investors to identify emerging markets and technologies while improving the dynamic adaptability and strategic depth of the ESG investment market.

5. Discussion

This study examines the impact of two core mechanisms of cognitive empathy—perspective-taking and fantasy—on ESG investment decision-making. The findings demonstrate that these mechanisms play a crucial role in encouraging investors to prioritise social and environmental values, offering unique psychological support for optimising investment decisions and achieving sustainable development goals.

Perspective-taking enables investors to understand social and environmental issues from others' viewpoints, enhancing their sense of social responsibility, improving decision quality, and encouraging the prioritisation of high-value projects with long-term returns. Through perspective-taking, investors can comprehensively assess the potential social benefits of projects, thereby balancing economic and social objectives. Fantasy, on the other hand, allows investors to intuitively perceive the social and environmental impacts of ESG projects through scenario simulation. This ability not only fosters investors' alignment with social values but also supports the exploration of innovative investment strategies to adapt to the dynamic nature of the ESG field. Furthermore, fantasy empowers investors to steadfastly support projects with extended return cycles, thereby strengthening their focus on long-term social benefits.

In summary, perspective-taking and fantasy provide significant theoretical and practical support for ESG investment, offering valuable insights into the psychological mechanisms that drive sustainable and socially responsible investment strategies.

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