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Does Sustainability Pay Off? Insights on EU Taxonomy and the Cost of Capital

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Content

Executive summary

This paper tests a central question for investors: does sustainability create financial value? To answer this, we use the EU Taxonomy as a novel proxy for corporate sustainability performance. Unlike ESG scores—which remain fragmented and inconsistent due to methodological differences—the EU Taxonomy provides a relatively standardized, transparent, and activity-based framework. This makes it a stronger basis for assessing whether sustainability is reflected in financing outcomes.

Analyzing data from more than 6,000 European non-financial companies for the 2024–25 financial year, we find robust evidence that sustainability performance, **measured by EU Taxonomy-aligned revenue, is associated with cheaper access to capital. A 10-percentage point increase in Taxonomy-aligned revenue corresponds to a 0.1 percentage point reduction in the weighted average cost of capital (WACC).** This demonstrates that sustainability can deliver measurable financial advantages.

The effect, however, is not uniform across industries. Capital-intensive sectors such as mining, construction, and real estate show a clear reduction in WACC with greater Taxonomy alignment. The wholesale and retail trade sector displays a different pattern, likely reflecting the limited availability of sustainable finance instruments tailored to this industry, which restricts its ability to capture the financing benefits observed elsewhere.

These results matter for investors. They provide empirical evidence that sustainability performance is more than a regulatory or reputational concern—it can shape financing costs and investment competitiveness. In an environment where sustainable funds saw record net outflows of €10.1 billion in Q1 2025, followed by a tentative €4.2 billion recovery in Q2, the findings underscore that sustainability continues to be a driver of long-term business value, even amid short-term market headwinds.

For investors and industry leaders, the implications are clear: sustainability performance, measured consistently through the EU Taxonomy, can inform capital allocation, enhance risk management, and open pathways to more efficient financing. In short, sustainability creates value—and the EU Taxonomy offers one of the most reliable tools currently available to measure it.

Why capital markets still care about ESG

ESG initiatives have faced growing challenges in 2025 due to mounting controversies, geopolitical tensions, and an evolving regulatory landscape. These headwinds have contributed to a cooling of the global ESG narrative, reflected in subdued investment sentiment. In the first quarter of 2025, sustainable open-end and exchange-traded funds experienced record-high net outflows of €10.1 billion, highlighting investor caution during a period of heightened uncertainty.[1] However, the second quarter showed signs of stabilisation, with the sector recording a net inflow of €4.2 billion, indicating a modest rebound and renewed, albeit cautious, investor interest[2].

Despite regulatory shifts and market headwinds, ESG is broadly recognized as a driver of long-term value creation. One of the clearest channels is its impact on the cost of capital. Research consistently demonstrates that companies with stronger ESG performance are able to access financing at lower costs. For instance, Ramirez et al.[3] find that in Latin America, a one-point increase in ESG score is associated with a 0.06 percentage point reduction in the cost of capital. Similarly, studies by MSCI[4] and Rohara[5] show that firms with higher ESG ratings consistently benefit from lower financing costs across developed markets such as the US, UK, Germany, Japan, and Australia.

ESG scores, despite their widespread use in research and investment analysis, remain somewhat subjective and vary across data providers due to differences in methodology, scope, and weighting criteria. This inconsistency can pose challenges when using ESG ratings as a definitive measure of corporate sustainability performance.[6]

In contrast, the EU Taxonomy establishes a more standardised and transparent framework by clearly defining environmental sustainability criteria for economic activities.[7] Hence, alignment with the EU Taxonomy offers a more consistent and reliable proxy for for evaluating both sustainability performance and its financial implications.

In this study, we assess whether stronger sustainability performance translates into a lower weighted average cost of capital (WACC). Our multivariate regression analysis shows that a 10 percentage point increase in EU Taxonomy-aligned revenue corresponds with a 0.1 percentage point reduction in the cost of capital. This suggests that companies with greater alignment can capture tangible financial benefits through reduced financing costs.

1 Using the conversion rate EUR 1 = USD 1.1643 as of August 7, 2025.

2 Morningstar, 2025.

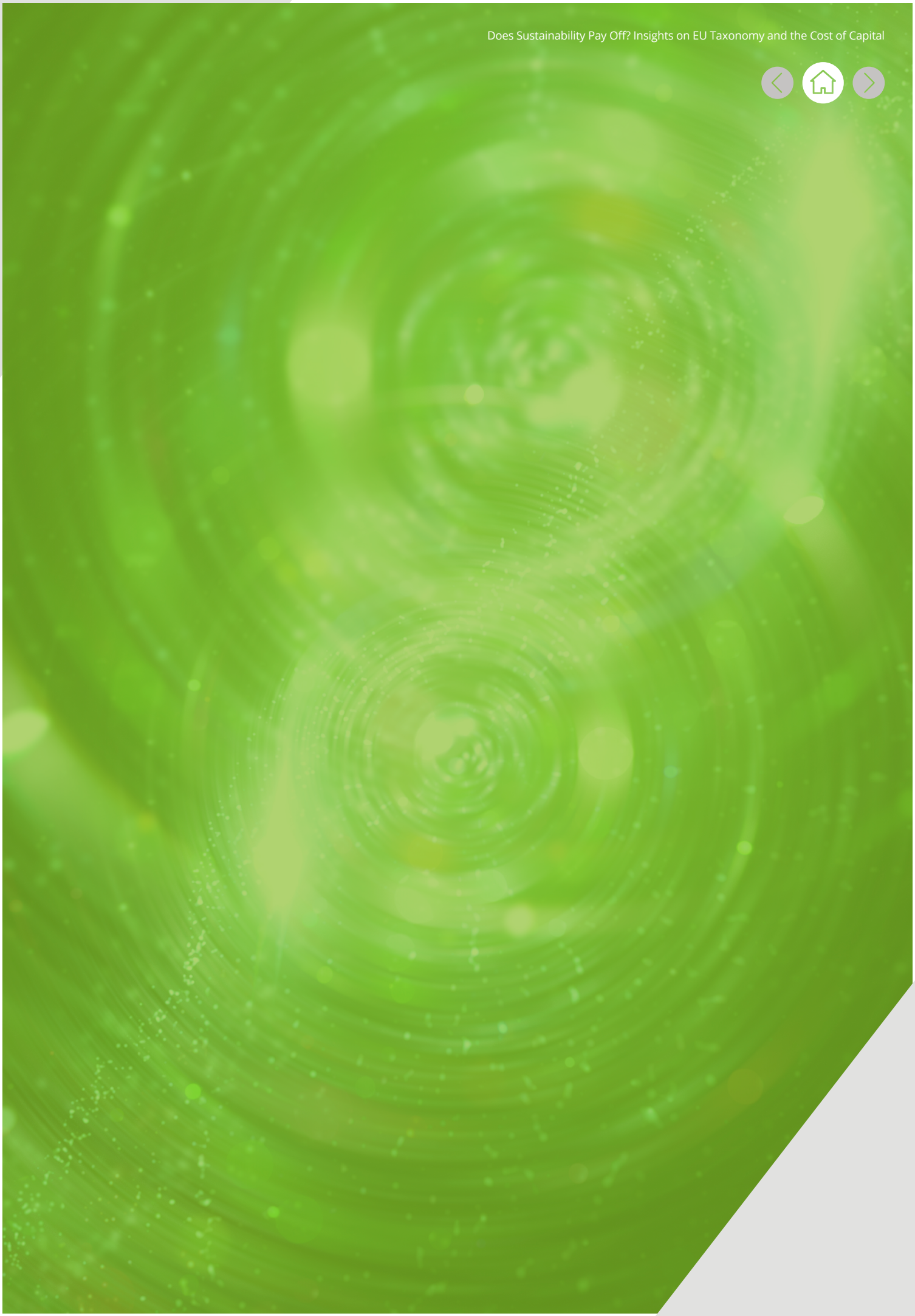
3 Ramirez et al., 2022.

4 MSCI, July 2024.

5 Rohara, 2025.

6 Berg et al., 2022.

7 Lucarelli et al., 2020.



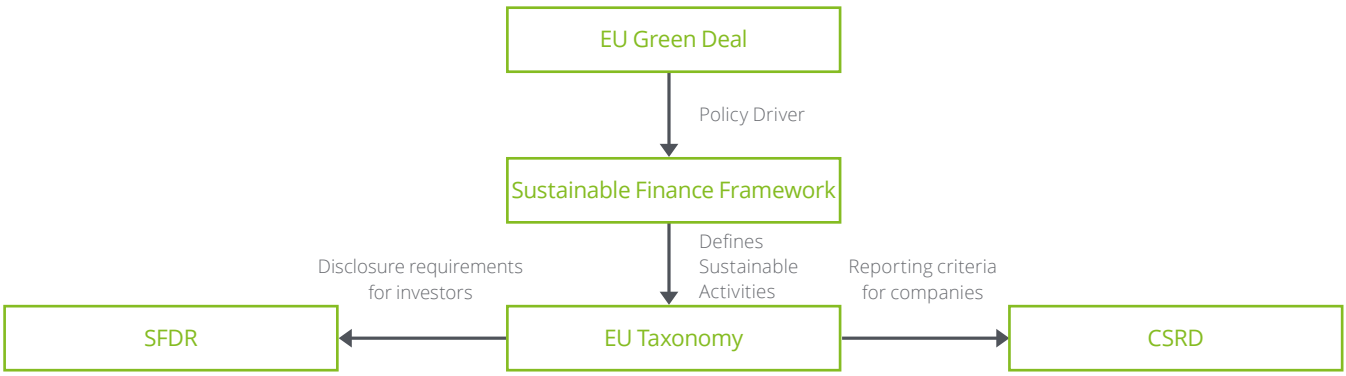
The EU Taxonomy: a common language for sustainability

In order to meet the objectives of the European Green Deal, investments must be directed towards sustainable projects and activities. The EU Taxonomy serves as the reference framework to identify environmentally sustainable activities.

The EU Taxonomy is a classification system that helps companies and investors distinguish environmentally sustainable economic activities from others when making sustainable investment decisions. These activities are described as those which:

- make a substantial contribution to at least one of the EU's climate and environmental objectives[8]
- do no significant harm to any of the other objectives, and
- meet minimum social safeguards (e.g., human rights and labour rights).

Figure 1: EU Sustainable Finance Framework



Note: SFDR and CSRD are selected examples within a broader ecosystem of regulations and directives referencing the EU Taxonomy.

Source: Deloitte

The EU taxonomy plays a growing role in helping the EU scale up sustainable investment, minimising greenwashing[9], and helping companies become more climate-friendly. For instance, companies may disclose their taxonomy-eligibility and taxonomy-alignment to provide transparency on the share of their businesses contributing to the EU's sustainability goals. More crucially for investors, the Sustainable Finance Disclosures Regulation (SFDR) uses the EU Taxonomy to define what sustainable investments are.

8 Climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, protection and restoration of biodiversity and ecosystems.

9 Greenwashing refers to misleading and deceptive conduct involving environmental, social or ethical claims to entice the market to purchase products or services, or to attract investment.

Measuring sustainability in financial markets

We have tested whether companies with a higher share of their revenue coming from activities aligned with the EU Taxonomy – meaning those that meet well-defined environmental sustainability criteria – exhibit a lower cost of capital, measured by their WACC. In other words, greater sustainability and a higher share of "green" revenue may enable companies to access debt at lower interest rates and raise equity capital more cheaply, consistent with lower perceived financial risk. Here, we consider two key questions:

Does a company's revenue alignment to the EU Taxonomy have a significant impact on its cost of capital?

Does the impact on company's cost of capital vary across different sectors?

To explore this, we have analysed data from over 6,000 non-financial companies across Europe using information from the LSEG database for the financial year 2024–25. Financial firms are excluded due to their distinct capital structures, which differ significantly from other industries. Using the multivariate ordinary least squares (OLS) method, we have estimated the impact of EU Taxonomy-aligned revenue on the weighted average cost of capital (WACC), after accounting for other company-specific covariates. This approach helps us isolate the specific effect of sustainable revenues of a company on its cost of capital by controlling for other influences that might also impact WACC (see Appendix for further details).

Figure 2: Methodology

Data collection

- 6,000+ non-financial companies from LSEG

Variable selection

- Taxonomy-aligned revenue
- Other company-specific covariates

Statistical analysis

- OLS regression to isolate effect on WACC

To explore industry heterogeneity, we have estimated sector-specific regression models to understand how the relationship between taxonomy alignment and WACC varies across sectors with different environmental exposures, capital structures, or regulations. Here, we have considered mining, construction, utilities, manufacturing, real estate, IT & professional services, and wholesale & retail trade as these sectors had sufficient observations to develop the OLS model.

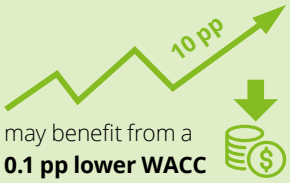
When sustainability lowers the cost of capital

We have identified two key insights that shed light on the financial implications of aligning revenue with the EU Taxonomy framework. Our analysis provides valuable guidance for companies seeking to understand how sustainability alignment influences their cost of capital and how this effect differs across key industries.

Overall impact

Our regression analysis shows that stronger EU Taxonomy alignment is associated with a lower weighted average cost of capital (WACC): a 10-percentage-point increase in revenue from environmentally sustainable activities corresponds to a 0.1-percentage-point reduction in the cost of capital. While the analysis does not distinguish whether this reflects an ESG discount (lower capital costs due to reduced risk) or an ESG premium (lower capital costs driven by stronger sustainability performance), the results align with evidence that financial markets are increasingly integrating sustainability considerations—whether explicitly or implicitly. Companies with a greater share of EU Taxonomy-aligned revenue may be perceived as facing lower regulatory, operational, and reputational risks, while also being better positioned to capture growth opportunities linked to consumer demand and policy incentives. These perceptions can translate into more favourable financing terms and, ultimately, a lower cost of capital.

Companies generating a **10 pp higher** share of EU taxonomy aligned revenue...



may benefit from a **0.1 pp lower WACC**

Sectoral variations in impact

Whilst overall results indicate that increased alignment with the EU Taxonomy corresponds to a reduction in the cost of capital, the strength and direction of this relationship varies significantly across different sectors, reflecting diverse industry characteristics and investor perceptions.

Most sectors exhibit a negative correlation between taxonomy alignment and WACC (cost of capital decreases as taxonomy increases, see Figure 3). Notably, underscoring a market preference for sustainability. Notably, the Mining and Quarrying sector experiences the largest impact on WACC. Given the sector's historically high environmental impact and regulatory scrutiny, capital providers appear to place a premium on companies demonstrating clear sustainability efforts, viewing them as less exposed to environmental liabilities and transition risks.[10] The higher impact of sustainability performance on cost of capital in the Mining and Quarrying sector signals the market's strong appetite for responsible practices in traditionally resource-intensive industries.

Similarly, sectors such as Construction, Information Technology, and Real Estate also show a significant decrease of WACC for companies with a higher share of revenue aligned to the EU Taxonomy. For Construction, sustainability targets often require compliance with stricter building codes, enhanced energy efficiency, and innovation in green materials, all of which mitigate future regulatory risks and reduce operational costs.[11,12] In Information Technology, sustainability aligns with energy-efficient data centres and responsible supply chains, enhancing long-term resilience. Real Estate benefits as well, with green buildings and sustainable property management increasingly demanded by tenants and investors, contributing to better asset valuation and reduced financing costs.[13]

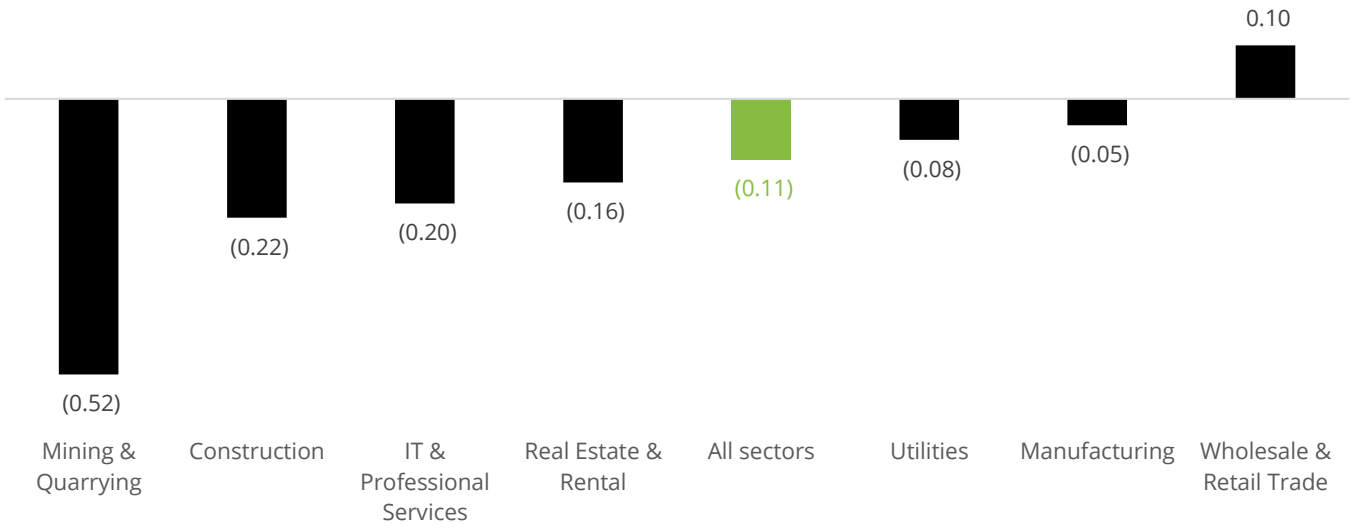
10 Onifade et al., 2024.

11 Firoozi et al., 2025.

12 Firoozi et al., 2024.

13 US Green Building Council, 2025.

Figure 3: Impact of a 10 percentage point increase in the EU taxonomy-aligned revenue on WACC (percentage point)



Source: Deloitte estimates.

In contrast, the wholesale and retail trade sector is the only one showing a positive correlation between EU Taxonomy alignment and WACC. A likely explanation is the limited availability of sustainable finance instruments—such as green bonds and sustainability-linked loans—targeted at this sector.[15] Sustainable debt markets remain concentrated in capital-intensive industries like real estate, utilities, and infrastructure, where Taxonomy-aligned projects can be more readily defined and financed. Retail and wholesale, by comparison, have far fewer eligible instruments, leaving companies unable to capture the financing benefits associated with sustainability performance. This may explain why, despite higher alignment, firms in the sector do not see the same reduction in WACC observed elsewhere.

Aside from the wholesale and retail trade sector, our findings broadly affirm a positive link between sustainability alignment and financial performance. This is consistent with evidence showing that sustainable finance instruments often deliver more favourable capital pricing.

15 Climate bond initiative, 2024

Sustainability as a value lever in deals and transactions

Sustainability performance is a growing factor of interest in M&A activities, with implications for deal valuation, risk assessment, and financing terms. Our study provides clear evidence that stronger sustainability performance is associated with a lower weighted average cost of capital (WACC) in most industries, reinforcing the financial relevance of sustainability beyond compliance or reputational considerations. In transactional contexts, this means that companies with robust sustainability credentials may be viewed as lower-risk targets, benefit from more favourable financing conditions, and potentially command higher valuations. As such, it is essential for both buyers and sellers to understand and rigorously evaluate a company's sustainability performance as part of due diligence. This insight can materially impact transaction structuring, pricing, and long-term value creation.

With this in mind, the considerations below highlight key areas investors may wish to examine both at the transaction level and across their broader **portfolio**.

Due diligence phase:

Transaction assessment: What proportion of the target's revenues and activities qualify under the EU Taxonomy, and how could this influence the cost and structure of financing for the deal?

Financial impact: How do ESG-related risks (e.g., carbon pricing, supply chain dependencies, regulatory shifts) translate into potential changes in cost of capital, access to sustainable finance, or asset valuation?

Data reliability: Is the ESG data disclosed by the company independently verified or auditable, and how consistent is it across subsidiaries, geographies, or reporting periods?

Comparative position: How does the target's ESG profile compare with sector peers, and could weaker alignment affect competitiveness in capital markets or procurement opportunities?

Post-transaction considerations:

Value-creation roadmap: Has a costed, time-bound plan been defined to increase sustainability performance in a measurable way, and is it integrated into the financial model?

Operational integration: How will sustainability reporting and data collection be embedded into existing finance, risk, and compliance processes—rather than run as a parallel system?

Incentives: Are ESG-related KPIs tied to executive compensation, debt covenants, or investor reporting obligations to ensure accountability?

Capital advantage: Can the company realistically access cheaper financing (e.g., green bonds, sustainability-linked loans) based on its current and projected ESG performance?

Monitoring: What mechanisms are in place for regular stress-testing of ESG risks (climate scenarios, regulatory tightening, supply chain shocks) and transparent investor updates?

Answering these questions will help investors better understand risks and opportunities related to EU Taxonomy alignment and broader ESG performance, enabling more informed decision-making in the evolving sustainability landscape.

Data and Methodology

In this study, we have examined the impact of EU Taxonomy-aligned revenues on firms' cost of capital, using quantitative data drawn from the LSEG database. We focus on the most recent company-level data available for the financial year 2024–25.
The dataset comprises 6,005 non-financial firms headquartered across Europe, in the Mining & quarrying, Construction, IT & Professional services, Real estate & rental, Utilities, Manufacturing and Wholesale & Retail trade sectors, with complete and valid data on Weighted Average Cost of Capital (WACC). We have excluded financial companies from the sample as their capital structure and regulatory environment is different, which can distort the underlying drivers of WACC relevant to corporates in other sectors.

Modelling framework

Our key objective is to assess whether a higher proportion of EU Taxonomy-aligned revenue – representing environmentally sustainable activities – effects a firm's cost of capital, specifically its WACC. Hence, the dependent variable is WACC, which reflects the firm's cost of financing through both debt and equity. The variable is expressed in percentage terms and sourced directly from the LSEG database. The key independent variable is the EU Taxonomy-Aligned Revenue, which measures the percentage share of a firm's total revenue that aligns with the EU Taxonomy classification for environmentally sustainable economic activities.

To ensure robustness, we have incorporated a range of company-specific covariates (Firm Controls) derived from both financial theory and prior empirical literature. These include beta, EBITDA margin, dividend payout ratio, return on equity, debt to equity ratio, Tobin's Q, firm size (viz., log of total assets), leverage ratio (viz., total debt to total assets ratio), return on assets (ROA), and ESG scores.

Given the influence of broader economic conditions on capital costs, we have also included country-level macroeconomic indicators (Macro Vars), such as GDP growth rate, inflation rate, unemployment rate, bank lending rate, and central bank policy rate. These macroeconomic indicators are matched to each firm based on the country of its headquarters.

We have applied the multivariate ordinary least squares (OLS) regression method as the core analytical framework. OLS is a widely used econometric technique that estimates the linear relationships between dependent and independent variables by minimising the sum of squared residuals.

Final regression model

We have selected the model with the highest adjusted R-squared that includes variables exhibiting coefficients with the expected signs and no evidence of multicollinearity. The final regression model comprises the share of EU Taxonomy Aligned Revenue, along with beta, EBITDA margin (%), dividend payout ratio, return on equity, debt to equity ratio, and the logarithm of total assets.
To explore heterogeneity across industries, we have further estimated sector-specific sub-sample regressions using the same model specification. This approach enables us an understanding of how the relationship between taxonomy alignment and WACC may vary by sectors, particularly in industries with distinct environmental exposure, capital structures, or regulatory contexts (e.g., mining and quarrying, construction, utilities, manufacturing, real estate, IT & professional services, and wholesale & retail trade). We considered only those sectors with an adequate number of observations to ensure statistical validity and representativeness.

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