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## ESG and CSR in Corporate Finance: A Review of Firm-Level Social Responsibility

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### ABSTRACT

In recent decades, the traditional paradigms of corporate finance—largely predicated on shareholder value maximization—have been increasingly challenged by the growing emphasis on corporate accountability, sustainability, and stakeholder engagement. This has led to a paradigm shift wherein Environmental, Social, and Governance (ESG) considerations and Corporate Social Responsibility (CSR) practices are no longer peripheral or voluntary actions but are becoming integral to the financial strategies and risk management frameworks of contemporary firms. This article presents a comprehensive, theory-driven review of the extant literature on ESG and CSR within the domain of corporate finance, with a particular focus on firm-level social responsibility and its financial implications. Drawing upon a multi-theoretical foundation—namely stakeholder theory, agency theory, legitimacy theory, institutional theory, and the resource-based view—the study critically examines how ESG and CSR are conceptualized and operationalized across various financial contexts. It explores the channels through which socially responsible practices influence firm valuation, cost of capital, investor behaviour, risk profiles, and long-term financial performance. Furthermore, the study evaluates how firms manage trade-offs between short-term

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profitability and long-term sustainability goals, and how institutional pressures, regulatory environments, and capital market dynamics shape ESG and CSR disclosures and performance. The review adopts a qualitative and thematic methodology, systematically analysing peer-reviewed literature published between 2000 and 2025 from reputable databases such as Scopus, Web of Science, JSTOR, and Google Scholar. Studies are categorized into key thematic clusters—including ESG and firm value, CSR and cost of capital, investor perception, sustainability disclosures, and governance dynamics—and examined for theoretical alignment, methodological rigor, and empirical consistency. The analysis highlights significant variation in findings across industries, regions, and institutional contexts, reflecting the heterogeneous nature of ESG/CSR implementation and measurement.

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## 1. Introduction

In the face of escalating global challenges—ranging from climate change and environmental degradation to income inequality and governance failures—corporations are increasingly expected to go beyond the narrow objective of profit maximization. This shift has brought heightened focus to the concepts of Environmental, Social, and Governance (ESG) and Corporate Social Responsibility (CSR), both of which represent evolving frameworks that seek to redefine the role of the firm in society. While ESG encompasses specific, quantifiable metrics related to a company’s impact on the environment, society, and governance structures, CSR tends to be broader, reflecting the voluntary ethical responsibilities and social initiatives undertaken by firms. Despite their conceptual differences, both ESG and CSR converge in their challenge to the traditional paradigms of corporate finance, which have long prioritized shareholder value as the principal—if not exclusive—goal of corporate behaviour.

Several theoretical frameworks provide the intellectual foundation for understanding the interaction between ESG/CSR and corporate finance. Stakeholder theory (Freeman, 1984), for instance, argues that firms must consider the interests of a broad spectrum of stakeholders—ranging from shareholders to employees, customers, communities, and ecosystems—if they are to achieve sustainable success. This theory directly challenges the narrow focus on financial returns and introduces a more inclusive value proposition. Firms that effectively manage stakeholder relationships are often rewarded with enhanced



reputation, customer loyalty, and reduced regulatory scrutiny, all of which can contribute to superior financial performance.

Conversely, agency theory (Jensen & Meckling, 1976) brings attention to the potential conflicts of interest between managers and shareholders, particularly regarding the deployment of resources toward non-financial goals. While critics argue that CSR initiatives may reflect managerial self-interest or lead to the misuse of shareholder funds, proponents have shown that ESG reporting and transparency mechanisms can reduce information asymmetry and align managerial incentives with long-term value creation. In particular, incorporating ESG factors into performance-based compensation and disclosure frameworks can mitigate agency problems and improve corporate governance outcomes.

From a strategic standpoint, the resource-based view (Barney, 1991) and dynamic capabilities theory (Teece et al., 1997) enrich the discussion by positioning ESG competencies as potential sources of competitive advantage. Firms that integrate sustainability into their operational and strategic fabric often develop intangible assets—such as brand equity, employee commitment, and innovation capacity—that are difficult for competitors to replicate. These assets contribute to long-term profitability and resilience in the face of volatility and uncertainty, reinforcing the case for ESG-oriented corporate strategy from a performance-based perspective.

In the realm of corporate finance, these theoretical perspectives are increasingly informing the way firms evaluate investment decisions, manage financial risk, and communicate value to shareholders. ESG metrics are now considered alongside traditional financial indicators in capital budgeting and valuation models. For example, firms with superior ESG ratings often enjoy lower costs of capital, reflecting reduced risk exposure and enhanced investor confidence (El Ghouli et al., 2011). Similarly, sustainable financial performance is increasingly associated with operational efficiencies, innovation, and stakeholder trust (Eccles et al., 2014). These trends underscore the growing relevance of ESG and CSR as both ethical imperatives and financial drivers.

This article aims to fill this gap by reviewing and synthesizing the growing body of research at the intersection of ESG, CSR, and corporate finance. By mapping the conceptual frameworks, identifying dominant themes, and highlighting empirical findings, this review contributes to a deeper understanding of how firm-level social responsibility is being redefined within financial theory and practice. In doing so, it lays the groundwork for future research and offers actionable insights for practitioners, policymakers, and investors seeking to navigate the evolving landscape of sustainable corporate finance.



## 2. Literature Review

The existing body of literature on ESG and CSR in corporate finance reveals a growing recognition of the strategic, ethical, and financial relevance of firm-level social responsibility. This section synthesizes key academic contributions across several thematic areas: (1) ESG and firm performance, (2) CSR and cost of capital, (3) investor behaviour and ESG disclosures, (4) corporate governance and sustainability, (5) ESG integration in financial decision-making.

### 2.1 ESG and Firm Performance

1. Friede, Busch, & Bassen (2015) conducted a meta-analysis of over 2,000 studies, finding a positive relationship between ESG performance and financial returns.
2. Eccles, Ioannou, & Serafeim (2014) reported that high-sustainability firms significantly outperform their low-sustainability peers in terms of stock returns and accounting performance.
3. Fatemi, Fooladi, & Tehranian (2015) argued that effective ESG strategies enhance corporate value by improving stakeholder trust.
4. Khan, Serafeim, & Yoon (2016) showed that material ESG investments are associated with future financial performance.
5. Albuquerque, Koskinen, & Zhang (2019) found ESG to act as a risk mitigator during market downturns.

### 2.2 CSR and Cost of Capital

6. El Ghouli et al. (2011) provided evidence that firms with superior CSR scores benefit from lower equity financing costs.
7. Goss & Roberts (2011) showed that banks charge higher interest rates to firms with weak CSR records.
8. Dhaliwal et al. (2011) concluded that voluntary CSR disclosures lead to a reduced cost of equity capital.



9. Cheng, Ioannou, & Serafeim (2014) posited that strong CSR performance reduces information asymmetry and, consequently, financing costs.
10. Awaysheh et al. (2020) confirmed that CSR engagement is inversely related to the cost of debt, especially in environmentally sensitive industries.

### **2.3 Investor Behavior and ESG Disclosures**

11. Krüger (2015) analyzed investor reactions to positive and negative ESG news, finding stronger market penalties for negative events.
12. Amel-Zadeh & Serafeim (2018) documented increasing ESG integration by institutional investors in valuation models.
13. Sassen, Hinze, & Hardeck (2016) showed ESG transparency enhances market valuation and investor trust.
14. Bauer, Derwall, & Hann (2009) revealed that socially responsible mutual funds outperform in ESG-compliant markets.
15. Fombrun & Shanley (1990) emphasized the role of reputation in financial markets through CSR visibility.

### **2.4 Corporate Governance and ESG**

16. Harjoto & Jo (2011) linked strong governance with higher CSR activity levels, arguing governance quality enables CSR engagement.
17. Jain, Sharma, & Srivastava (2019) found board diversity positively associated with ESG score improvements.
18. Mallin, Michelin, & Raggi (2013) discussed how shareholder activism encourages ESG disclosures.
19. Rao & Tilt (2016) argued that board independence promotes more rigorous sustainability reporting.



20. García-Sánchez, Rodríguez-Ariza, & Frías-Aceituno (2013) demonstrated that women on boards positively influence CSR strategy.

## 2.5 ESG Integration in Financial Decision-Making

21. Richardson & Welker (2001) found firms with more detailed social disclosures faced reduced analyst forecast dispersion.

22. Clark, Feiner, & Viehs (2015) argued ESG factors are economically material and critical to investment decision-making.

23. Lee, Faff, & Langfield-Smith (2009) showed positive market reaction to socially responsible investment decisions.

24. Hsu, Liang, & Matos (2018) identified ESG performance as a determinant of capital budgeting and project risk assessment.

25. Capelle-Blancard & Petit (2019) reviewed the influence of ESG factors on credit rating decisions.

## 3. Theoretical Background

The theoretical foundation of ESG and CSR in corporate finance can be situated within several interrelated frameworks, including stakeholder theory, agency theory, legitimacy theory, and institutional theory. These theories collectively provide the intellectual scaffolding to understand how and why firms integrate ESG and CSR dimensions into their strategic and financial frameworks.

### 3.1 Stakeholder Theory

Stakeholder theory (Freeman, 1984) posits that the firm has a responsibility not only to its shareholders but also to a broader set of stakeholders, including employees, customers, suppliers, communities, and the environment. From this perspective, ESG and CSR activities are not peripheral or discretionary but are central to sustainable value creation. Stakeholder engagement and responsiveness are seen as strategic imperatives, enhancing the firm's legitimacy, reputation, and long-term performance. In corporate finance, stakeholder theory justifies incorporating ESG risks and opportunities into capital budgeting, investment appraisal, and financing decisions, as these factors influence stakeholder relations and, by extension, firm value.



### 3.2 Agency Theory

Agency theory (Jensen & Meckling, 1976) introduces the problem of conflicts of interest between managers (agents) and shareholders (principals). Critics of CSR argue that discretionary social spending may be symptomatic of managerial entrenchment or empire-building behaviour, leading to agency costs. However, contemporary extensions of agency theory have recognized that ESG and CSR disclosures can act as signalling mechanisms to reduce information asymmetry and align interests. By increasing transparency and accountability, ESG reporting may mitigate agency problems, improve investor confidence, and reduce the cost of capital (Dhaliwal et al., 2011). Moreover, ESG-oriented compensation structures are increasingly used to align executive incentives with long-term sustainability goals.

### 3.3 Legitimacy Theory

Legitimacy theory (Suchman, 1995; Deegan, 2002) offers a sociological explanation for corporate social responsibility behavior, suggesting that firms engage in ESG and CSR practices to secure social legitimacy and maintain a license to operate. This theory posits that corporations are embedded in a social environment that grants them the legitimacy necessary for survival. In this context, ESG initiatives and CSR reporting function as tools to demonstrate alignment with societal norms and expectations, thereby protecting firm reputation and reducing the risk of regulatory sanctions or consumer boycotts. Legitimacy theory explains why firms may adopt ESG policies even in the absence of immediate financial returns.

### 3.4 Institutional Theory

Institutional theory (DiMaggio & Powell, 1983) emphasizes the role of formal and informal institutions in shaping organizational behaviour. Firms often adopt ESG and CSR practices in response to coercive pressures (e.g., regulations), normative pressures (e.g., professional standards), and mimetic pressures (e.g., imitation of peers). In financial markets, institutional investors, rating agencies, and stock exchanges increasingly demand ESG disclosures, creating institutional incentives for firms to conform to ESG norms. Institutional theory thus provides a useful lens to understand the diffusion of ESG practices across industries and geographies, particularly in the context of globalization and financialization.

## 4. Methodology



This study adopts a qualitative, descriptive, and analytical research design grounded in the principles of systematic literature review. The methodology involves three main stages:

#### **4.1 Literature Collection:**

An extensive review of peer-reviewed journal articles, academic books, and institutional reports was conducted. Databases including Scopus, Web of Science, JSTOR, and Google Scholar were used to identify relevant literature published between 2000 and 2025. Keywords used for search included: ESG performance, corporate social responsibility, corporate finance, stakeholder theory, sustainability reporting, ESG and cost of capital, and CSR and firm performance.

#### **4.2 Inclusion and Exclusion Criteria:**

Only scholarly articles that directly address the linkages between ESG/CSR and corporate finance were included. Studies purely focused on sustainability without a financial angle, or those limited to legal or purely ethical discourses, were excluded. Preference was given to empirical studies, meta-analyses, and theory-driven papers in high-impact journals.

#### **4.3 Thematic and Theoretical Analysis:**

The selected literature was categorized thematically into areas such as ESG and firm performance, CSR and cost of capital, investor reactions, governance mechanisms, and institutional influences. Simultaneously, theoretical framing was evaluated to understand how various perspectives—such as stakeholder theory, agency theory, legitimacy theory, institutional theory, and resource-based views—were employed in the literature.

The methodological rigor of this review lies in its structured approach to synthesis, critical appraisal of findings, and identification of research gaps. The objective is not merely to summarize existing knowledge but to analytically interrogate its coherence, relevance, and future applicability in an evolving financial and regulatory environment.

### **5. Conclusion**

The findings from the review of literature on ESG and CSR in the context of corporate finance underscore a clear and progressive evolution in both scholarly and practitioner thinking. What was once considered an ethical or reputational consideration peripheral to core financial decisions has now



emerged as a critical determinant of firm-level financial performance and risk management. This shift is theoretically anchored in frameworks such as stakeholder theory, legitimacy theory, and institutional theory, all of which challenge the narrow confines of neoclassical finance that prioritize shareholder wealth maximization to the exclusion of broader stakeholder interests.

A key insight from this review is the multidimensional nature of ESG and CSR initiatives, which simultaneously impact firms through both internal financial mechanisms and external market perceptions. The internal benefits include improved operational efficiency, reduced cost of capital, and long-term value creation through sustainable innovation and stakeholder trust. Externally, socially responsible firms tend to enjoy favourable investor sentiment, higher levels of institutional ownership, and enhanced reputational capital—factors that translate into market-based financial premiums.

Nevertheless, the empirical findings across the literature are not uniformly consistent. Some studies demonstrate a robust positive relationship between ESG/CSR and firm performance, while others report neutral or even negative effects, particularly in the short term. These discrepancies can be attributed to several contextual variables such as firm size, industry characteristics, regional regulatory environments, and the measurement models used for ESG and CSR indices. The lack of standardization in ESG metrics and disclosure practices further complicates cross-study comparisons, signalling the need for greater methodological convergence.

Additionally, the literature reveals a persistent gap between ESG/CSR adoption and integration into corporate financial strategy. While many firms engage in disclosure and symbolic actions to satisfy regulatory or societal expectations—a phenomenon described as “greenwashing” in some cases—the strategic embedding of ESG principles into decision-making remains uneven. This reveals a theoretical and practical tension: firms may seek legitimacy and social acceptance through ESG signalling yet fall short of transforming these commitments into value-generating financial strategies.

Furthermore, the discussion highlights the growing importance of institutional pressures and stakeholder activism in influencing corporate behaviour. Regulatory mandates, ESG-oriented investment funds, and public scrutiny are catalysing a transition toward greater accountability and transparency. However, institutional voids—particularly in emerging markets—may constrain the effectiveness and enforcement of such initiatives.



Ultimately, this study suggests that ESG and CSR are not merely normative constructs but are increasingly intertwined with firm survival, competitiveness, and legitimacy in contemporary financial ecosystems. As financial markets move toward sustainability-driven evaluations, there is a critical need for interdisciplinary approaches that bridge finance, governance, strategy, and ethics. Future research should focus on longitudinal data, sector-specific case studies, and comparative cross-country analyses to capture the complexity and heterogeneity of ESG/CSR-finance relationships.

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