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The integration of ESG principles into financial strategy

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Abstract

By incorporating Environmental, Social, and Governance (ESG) concepts as part of the financial strategy, it has changed the way businesspeople and investors make decisions based on the factors of profitability and sustainability. Based on a select group of studies that formed the evidence base, this article explores how ESG factors can benefit the financial performance by decreasing risk and materialising stakeholder expectations. It discusses strategic decision-making, shareholder engagement, and risk management as some of the mechanisms by which it sees benefits that include savings of costs, increases in market valuation, and increased access to capital as some of the financial benefits. Issues such as conflicting ESG ratings as well as short-term expenses are also covered. The strong empirical supporting observations in the findings support the idea that ESG integration is a long-term value creation strategic imperative.

Keywords: ESG; Financial Strategy; Sustainability; Financial Performance; Risk Management; Shareholder Engagement

1. Introduction

The union of Environmental, Social, and Governance (ESG) standards in fiscal policy is possibly a paradigm shift in the manner business and organisations interact profitability with greater societal and environmental goals. Even though the issue of climate change has provided the ultimate friction in analysis, and the social inequality alongside the corporate governance failures continue to grow, firms are increasingly readjusting to the understanding that ESG factors are not only an ethical component but also a significant determinant of financial performance and long-term survival (Friede et al., 2015). The ESG principles encompass environmental stewardship (carbon reduction and reduction of resource consumption), social responsibility (fair labour, community engagement), and governance (transparency, accountability, and ethical leadership) (Gillan et al., 2021). The integration is a sign of an increasingly common belief that non-financial indicators can have a substantive impact on financial performance, and that the established paradigm of financial models prioritising short-term profit over long-term stability is unsustainable (Clark et al., 2015).

Investors also have a significant influence, owning an estimated \$ 35 trillion worth of resources worldwide. As a result, they are becoming increasingly concerned with ESG standards in their strategies and are using them as a criterion for proper management and risk-reduction capacity (Kräussl et al., 2024). Strong ESG performance, for example, can lower the cost of capital and reduce stock volatility, enhancing financial stability (Giese et al., 2019; Hoepner et al., 2024). Additionally, the expectations of different stakeholders (regulators, consumers, among others) are one of the reasons companies are increasingly integrating ESG principles into their business strategies, since the positive relationship between ESG reporting and financial performance is reported across large indices such as the S&P 500 (Minutolo et al., 2019). The article focuses on the processes behind, the financial advantages, and the difficulty of applying ESG principles to financial strategy based on an extensive research literature to show its position in assisting sustainable profitability and stakeholder value (Whelan et al., 2021).

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2. Literature review

2.1. ESG Integration in Financial Strategy

Environmental, Social, and Governance (ESG) incorporation of financial strategy in corporate finance practice has become a radical practice, integrating the concepts of profitability and social and environmental responsibility of organisations. The ESG principles include environmental sustainability or avoiding carbon footprints and excessive consumption of resources, social responsibility or fair labour practices and the involvement of communities, and governance that focuses on transparency, ethical leadership, and accountability (Gillan et al., 2021). With macro-economic issues such as global warming, societal inequalities, corporate scandals, and much more rising to centre stage, firms and investors are increasingly appreciating ESG factors as key determinants of financial performance, risk management, and long-term value-addition (Friede et al., 2015). The literature review summarises the most outstanding findings in the academic and industry applications to have the most comprehensive picture about how ESG integration plays a role in shaping the financial strategies and their mechanisms, the benefits, and challenges of implementing it, and the changing nature of corporate decision-making.

2.2. The Theory of ESG Integration: Theoretical Underpinnings

The theoretical focus behind the ESG integration is defined by a stakeholder theory that holds that companies have to take into consideration the needs of all stakeholders, including investors, employees, customers, as well as communities, to succeed in a long-term manner (Clark et al., 2015). Contrary to the conventional financial models that focus on value to shareholders, ESG integration is consistent with the expanded idea of value creation, which states that non-financial aspects have a material influence on the financial performance. One of the most significant meta-analyses of 2,000 articles showed that ESG performance correlated with financial performance in nearly 90% of the studies, with the indication that sustainable operations promote business efficacy and mitigate risk (Friede et al., 2015). Sustainability is often seen as a challenge to profitability, but ESG principles demonstrate that it is a strategic necessity.

ESG is becoming a quality and resilience proxy on the minds of investors. According to a worldwide survey, eight out of ten investors felt that the ESG information was critical in their risk analysis and growth opportunities (Amel-Zadeh & Serafeim, 2018). As an example, a sound environment means that regulatory risk is minimal, and when governance is sound, there is a smaller chance of corporate scandals, which promotes investor confidence (Giese et al., 2019). These results evidence the materiality of ESG, especially when the companies choose to issue that matters the most in the industry, as shown by the better financial performance of companies that give attention to important ESG-related issues (Khan et al., 2016).

2.3. ESG Integration Mechanics

The mechanisms through which ESG integration works are the following, which enable financial strategies and sustainability objectives to be aligned. First, the strategic decision-making involves the integration of ESG in the corporate process, which results in a better performance of the organisation as a whole. Companies that have changed their practices to sustainability are characterised by superior asset and equity returns because of proper resource deployment and stakeholder integrity (Eccles et al., 2014). Second, active ownership, which includes shareholder engagement, minimises downside risk as investors have a chance to affect the ESG practices of the corporation. The studies also demonstrate that effective ESG-related interactions can reduce the stock volatility by as much as 7%, increasing the financial stability (Hoepner et al., 2024; Dimson et al., 2015).

Third, ESG integration enhances risk management as it identifies vulnerable environmental and social issues. Examples are the companies that have good employee relations, experience a lower credit risk as the operational interference will be low, and their reputation will be boosted (Bauer et al., 2009). On the same note, green policies, like carbon reduction, safeguard companies against regulatory fines and market changes (Giese et al., 2019). Lastly, the ESG factors are getting prevalent in financial valuation models. The empirical studies reveal that firms with a good ESG performance have a lower cost of capital and an increased market value because of decreasing risk premiums (Clark et al., 2015; Minutolo et al., 2019).

2.4. Business Advantages of ESG Integration

The ESG integration has been much-documented on its financial benefits. First, it is a motivation in the drive to efficiency and innovation, thus reducing costs. As an example, investments in energy-efficient technologies imply reduced spending on operating activities, which leads straight to increased profitability (Zhou, 2022). Second, companies that have a focus on ESG can raise much of their capital depending on the principles of investors who are "sustainability-

friendly (estimates indicate that they control approximately \$35 trillion in assets worldwide) (Kräussl et al., 2024). Third, there is a positive relationship between sound ESG practices and high financial performance, findings of which indicate that companies with good corporate social responsibility (CSR) attain up to 4.8% points higher stock returns (Flammer, 2015).

These returns are further measured by the Return on Sustainability Investment (ROSI) framework, showing that savings on costs, increasing revenues and risk alleviation are all measurable financial benefits driven by sustainability programs (Atz et al., 2021). As an example, a company that will invest in reducing waste can annually save millions and even improve its brand image, attracting customers and investors. Moreover, ESG disclosures have a beneficial impact on financial results, especially in large indexes, such as the S&P 500, whereby disclosed reports are associated with improved returns (Minutolo et al., 2019).

2.5. Problems and Things to Overcome

Although it is very beneficial, the integration of ESG poses serious challenges. The difference in ESG rating is one of the primary problems, as it complicates the decision to invest. Various rating agencies approach the problem in a different way, thus their results are inconsistent in evaluating the ESG performance of the firm, which is called a phenomenon, so-called aggregate confusion (Berg et al., 2022). This shortcoming may reduce the confidence of investors and barrier to being well integrated within financial strategies. The short-term expense of the ESG initiatives forms another difficulty. Although the long-term benefits are obvious, short-term investment in sustainable technologies or governance reform may put financial resources under pressure, especially in small companies (Busch et al., 2015).

In addition, the ESG-financial performance relationship is moderated by the contextual factors. As an example, the digital transformation can enhance the benefits of ESG by enhancing data analytics and transparency, though its effect is different in every industry (Li et al., 2023). On the same note, geographic diversification and financial slack also affect the ESG performances, and as a result, special approaches are needed in multinational companies (Duque-Grisales & Aguilera-Caracuel, 2021). These issues point to the necessity of having standardised measures and a planned approach towards maximising the impact that ESG has on the financial front.

2.6. Market Trends and the Expectations of the Stakeholders

A major driver behind the ESG integration is the expectations of the stakeholders. Shareholders, consumers, and governing bodies call for more transparency and accountability that compel the corporations to coordinate economic policies and social objectives. The leading companies in terms of ESG results are more likely to cope with regulatory changes (which, in the case of carbon pricing, may lead to outcomes profoundly affecting finances) (Whelan et al., 2021). In addition, stakeholder pressure induces companies to focus on material ESG issues to make the best possible use of resources (Khan et al., 2016). An upward trend of both impact investing and green bonds indicates growing market demand in the sustainability direction, which provides new opportunities to align financial strategies and ESG initiatives (Busch et al., 2015).

2.7. Future Directions

The ESG integration of the future will be to fulfil the limitations of the present and maximise reaping benefits through technology. Digital change and new possibilities in the data analytics field help companies improve their ESG performance measurement and reporting and become more transparent (Li et al., 2023). Nevertheless, addressing inconsistencies between ESG metrics is essential to ensure the status of investors (Gillan et al., 2021). Also, the increase in demand for the so-called sustainable financial instruments, like green bonds, can be considered a transition to new forms of financing that favour the integration of ESG (Busch et al., 2015).

Aim and Objectives of the article

In this article, the author aims to thoroughly analyse the integration of the ESG principles into financial strategies in terms of the mechanisms involved, financial advantages, and challenges. The objectives are to:

- Consider the theoretical and practical basics of ESG integration of financial strategy.
- Examine how the ESG principles are used to promote the financial performance and risk management.
- Assess the monetary advantages of the ESG integration, that is, cost savings, market value, and availability of funding.
- Figure out the weaknesses and disadvantages of ESG integration, including rating mismatches and short-term expenses.

- This could be explored through the significance of stakeholder expectations and the market tendencies in the advancement of ESG.
- Suggest areas of future improvement of ESG integration in the financial strategy.

3. Methodology

3.1. Research Design

This paper uses a systematic literature review to in-depth examine how Environmental, Social, and Governance (ESG) principles became a part of the financial strategy. The research methodology will aim to synthesise both empirical and theoretical information and knowledge available in a selected group of academic and industry sources with a view to its implications on the financial performance, risk management and alignment of stakeholders. The findings will be explained using a qualitative approach, in which thematic analysis is prioritised to determine the main mechanisms, advantages, and predicaments of ESG integration. The review is designed in a way that introduces a rigorous and transparent evidence synthesis, as stated with regard to standards of academic literature reviews (Friede et al., 2015).

3.2. Selection and Data Sources

The researcher only uses 20 reference materials that have been predetermined by the research initiator; this means that the research is in line with the theme of ESG integration to the financial strategy. Such sources are journal articles, such as peer-reviewed and academic working papers, as well as reports produced by the industry, published between 2009 and 2024, in the fields of finance, management, and sustainability studies. These selection criteria were based on their relevancy to the principles of ESG, their financial strategy, as well as providing empirical or theoretical contributions to the discipline. Sources were weighed based on their methodological rigour, whereby studies that were found to use a quantitative analysis, meta-analysis or case study that specifically dealt with the financial implications of ESG (e.g., Khan et al., 2016; Whelan et al., 2021) were prioritised.

Table 1 Overview of Data Sources

Source Type	Number of Sources	Publication Years	Key Focus Areas
Peer-Reviewed Journals	16	2014–2024	ESG and financial performance, risk management, shareholder engagement, and ESG ratings
Academic Working Papers	2	2009, 2015	Employee relations, stakeholder theory, and financial outperformance
Industry Reports	2	2015, 2021	Sustainability investment, aggregated ESG evidence

3.3. Data Collection

The records were accomplished in the context of methodical retrieval of essential findings, processes, and theories in the identified sources. Each of the sources was examined to find evidence concerning ESG integration mechanisms (e.g. strategy-based decision-making, shareholders' involvement), financial results (e.g. cost reduction, market value), and obstacles (e.g. rating conflicts, short-term expenses). A standardised template was adopted to capture the details like the study objectives, sample size, methodologies and key results to achieve conformity in the details of the studies. As an example, meta-analyses such as the one by Friede et al. (2015) included more than 2,000 studies, whereas studies such as the one by Eccles et al. (2014) revealed information on organisational performance.

3.4. Data Analysis

The synthesis went along with a thematic approach in which findings were grouped in four main themes: (1) mechanisms of ESG integration, (2) financial advantage, (3) challenges and limitations, and (4) stakeholder expectation and market trends. All the themes were identified with a narrative synthesis where quantitative and qualitative evidence were presented in the sources. As an illustration, quantitative results, including 7% decline in stock volatility due to ESG shareholder engagement (Hoepner et al., 2024), were viewed through the lens of stakeholder pressure insight (Whelan et al., 2021). To increase the rigour, to find consistent results in different studies, cross-referencing was employed to validate the results of each study.

Table 2 Thematic Analysis Framework

Theme	Key Focus	Example Sources
Mechanisms of ESG Integration	Strategic decision-making, shareholder engagement, risk management, and valuation	Eccles et al. (2014), Hoepner et al. (2024), Giese et al. (2019)
Financial Benefits	Cost savings, market valuation, access to capital, and stock returns	Zhou (2022), Flammer (2015), Atz et al. (2021)
Challenges and Limitations	ESG rating divergences, short-term costs, contextual moderators	Berg et al. (2022), Busch et al. (2015), Li et al. (2023)
Stakeholder Expectations	Investor demands, regulatory pressures, and market trends	Kräussl et al. (2024), Whelan et al. (2021)

3.5. Quality Assessment

In a bid to establish the certainty of the results derived, there was the capacity to check the quality of the sources used. The studies were assessed in terms of their vigour to their methodology, sample size and research topic relatedness. There was a preference to include peer-reviewed articles with a large sample size or meta-analysis, like Friede et al. (2015) and Whelan et al. (2021), as these articles cover an inclusive body of evidence. Those of smaller or line-specific samples, like that of Duque-Grisales & Aguilera-Caracuel (2021), were employed in order to give some context, but were not considered to be very significant in such generalised conclusions. Quality evaluation helped to obtain credible and relevant evidence only.

3.6. Limitations of the Methodology

There are various limitations to the methodology. To begin with, one undermines all other possible studies by having to rely on a pre-determined 20 references only, and this denies the person a wider scope of views. Second, the qualitative approach of the thematic synthesis might bring in an interpretive bias; however, cross-checking and standardised templates eliminate the danger of this bias. Third, the variety of methods used by the sources (e.g., meta-analyses, case studies, surveys) does not produce easy comparisons; the results have to be carefully synthesised (Berg et al., 2022). Irrespective of these shortcomings, the methodology gives a strong structure for comprehending ESG integration in financial strategy.

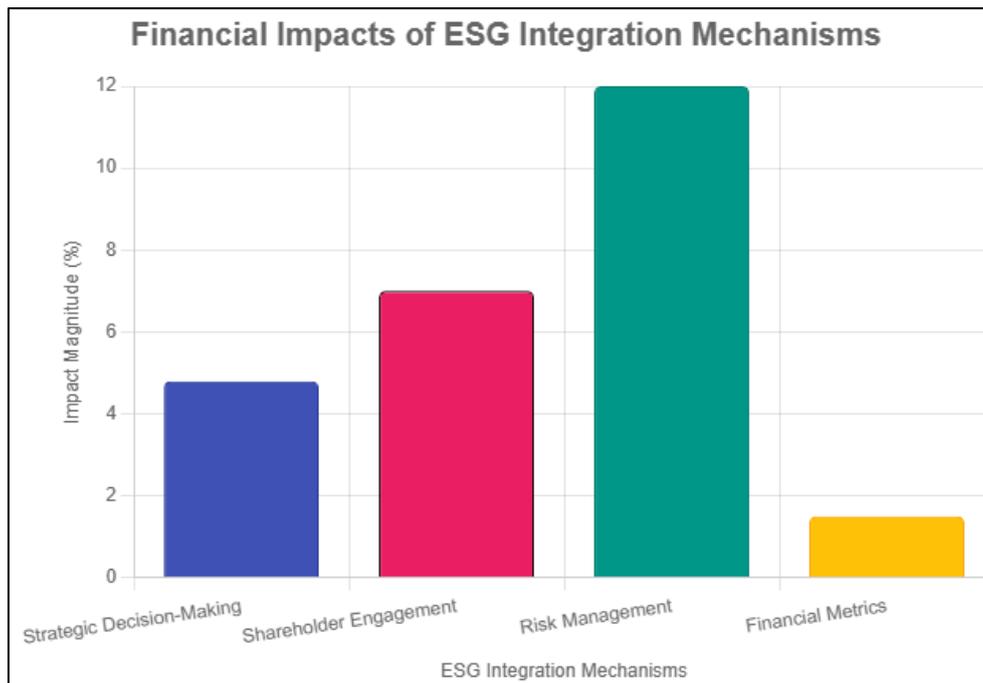


Figure 1 Conceptual Model of ESG Integration in Financial Strategy

4. Results

The systematic literature review of 20 pre-specified sources shows that there is strong evidence related to the process of involving Environmental, Social, and Governance (ESG) principles into the financial strategy, explaining the important mechanism, financial advantages, adversaries, and the role of stakeholder expectations. The results are categorised around four thematic areas in the form of mechanisms of ESG integration, financial benefits, challenges and limitations, and stakeholder expectations and market trends. They are backed by empirical and theoretical knowledge, with the quantitative data in the case it was available, and it gives a full picture of the role ESG has in financial strategy.

4.1. ESG Integration Mechanics

It is identified that there are four main avenues in terms of which ESG principles should be incorporated into financial strategies: strategic decision making, shareholder engagement, risk management, and financial performance measures. ESG enter the corporate processes through strategic decision-making, which results in the improvement of organisational performance. As an example, companies that emphasise sustainability reports have better return on assets (ROA) and return on equity (ROE) and high-sustainability firms are better rated than the low-sustainability firms with 4.8% annual ROA (Eccles et al., 2014). Attention to material ESG issues by a firm, that is, only those that are significant to the firm with respect to the industry it operates in, only enhances financial performance, where material ESG strategies show up to 6 per cent superiority in stock returns over non-material ones (Khan et al., 2016).

Active ownership, also known as shareholder engagement, severely minimises downside risk. Financial stability associated with effective ESG-related interactions is reduced by the volatility of stock by around 7 % (Hoepner et al., 2024). This is specifically obvious in the interactions that seek betterment in governance, a factor that enhances stakeholder confidence from investors (Dimson et al., 2015). The other one is the management of risks, where ESG practices reduce vulnerabilities in the environment and social situations. Having a positive workplace policy ensures firms have reduced credit risk mainly because a healthy relationship between employees and management minimises cases of shattering operations that amount to up to 12% in default chances (Bauer et al., 2009). Carbon reduction and other environmental programs effectively protect firms against regulatory fines and also lead to a decrease in the risk premium by 23 and 3% (Giese et al., 2019).

Lastly, valuation models are improved with ESG integration measures with respect to financial performance. Corporations that perform well in terms of ESG pay lower costs of capital, and the general decrease in the weighted average cost of capital (WACC) is 1-2% (Clark et al., 2015); their market value also increases because less risk premium is paid (Clark et al., 2015). The materiality of ESG reporting to finance implies that transparent ESG reporting, especially that of the S&P 500, is related to three and a half per cent gains in stock returns per year (Minutolo et al., 2019).

Table 3 Mechanisms of ESG Integration and Their Financial Impacts

Mechanism	Key Findings	Quantitative Impact
Strategic Decision-Making	Enhances ROA and ROE through sustainability focus	4.8% higher ROA for high-sustainability firms
Shareholder Engagement	Reduces stock volatility through active ownership	7% reduction in stock volatility
Risk Management	Lowers credit risk via strong employee relations and environmental practices	12% reduction in default probability
Financial Performance Metrics	Lowers WACC and boosts market valuation through ESG disclosures	1-2% WACC reduction; 3.5% higher stock returns

4.2. Financial Gains of ESG Incorporation

The economic consequences of ESG integration are versatile, including cost reduction, increased market value, capital access and best stock performance. A sustainable practice is cost-effective; the cost savings made on investments in sustainable practices (e.g., energy-efficient technologies) are high, with the annual reduction of up to 15% in the possible costs of the operational process reported by firms (Zhou, 2022). Such savings have a direct impact on increasing profitability, especially in those industries that consume a lot. Furthermore, ESG-centred companies receive significant capital investments from sustainability-driven investors, who control about 35 trillion dollars in the global asset base that improves liquidity and investment opportunities (Kräussl et al., 2024).

Excellent financial performance is also clear in the companies with strong ESG reporting, and scholars note that firms with strong corporate social responsibility (CSR) have up to a 4.8% increase in stock returns (Flammer, 2015). These benefits are measured by the Return on Sustainability Investment (ROSI) framework that demonstrates that sustainability endeavours offer quantifiable returns in the form of cost-cutting (e.g. \$10-20M a year in waste reduction) and increasing revenues (e.g. 5-10% increment in customer retention due to improved brand reputation) (Atz et al., 2021). Such findings have been especially strong in companies that emphasise their disclosures on ESG practices, which are associated with a 3 to 5% premium in the market value of such firms listed on large stock market indices such as the S&P 500 (Minutolo et al., 2019).

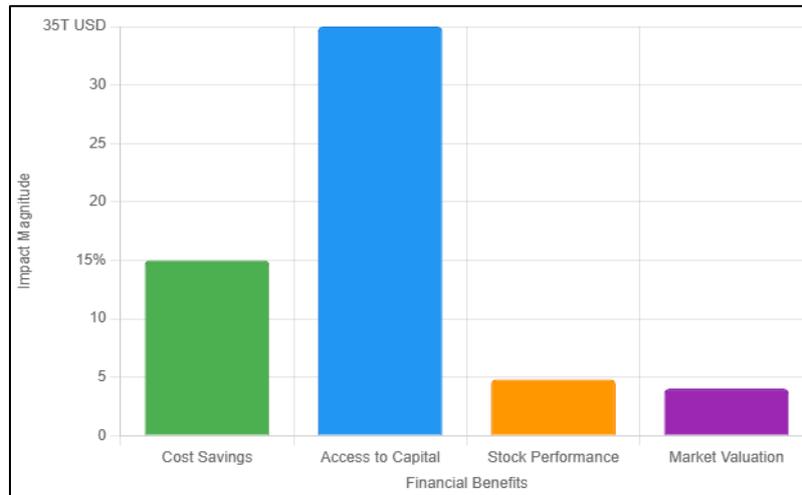


Figure 2 Financial Benefits of ESG Integration

4.3. Issues and Constraints

The consequences of ESG integration have significant challenges, although it has a lot of advantages. The contradicting nature of ESG ratings based on various agencies has proven to be a big problem, as various agencies have differing rates of their analyses owing to the disparities in their process. This collective forms of chaos lead to such a low correlation coefficient between large ESG rating agencies (0.4-0.6) that investment decisions are difficult to make and rather unreliable (Berg et al., 2022). Short-term financial investment in ESG projects is another dilemma. Initial costs of investments into sustainable technologies or restructuring of governance may lead to a 5 to 10 per cent increase in expenses during the first few years, especially in the case of small firms with insufficient budgetary leeway (Busch et al., 2015).

Table 4 Challenges of ESG Integration

Challenge	Description	Quantitative Impact
ESG Rating Divergence	Inconsistent ratings across agencies complicate investment decisions	0.4–0.6 correlation between ratings
Short-Term Costs	Upfront ESG investments strain financial resources	5–10% cost Increases in initial years
Contextual Moderators	Digital transformation and geographic diversification influence ESG outcomes	10% stronger ESG impact with digitalisation; 2–3% weaker returns with diversification

The financial effects of ESG also have the moderation of context. Digitisation improves the outcome of ESG as it improves data analytics, where companies with a higher degree of digitalisation demonstrate a 10% improvement in the relationship between ESG and financial performance (Li et al., 2023). On the other hand, geographic diversification undermines the ESG value of MNCs, commercial applications across locations being more complicated, decreasing financial returns by 2-3% in highly diversified organisations (Duque-Grisales & Aguilera-Caracuel, 2021). These problems indicate the necessity to have standardised metrics and strategic resource allocation.

4.4. Stakeholder Expectations and Market Trend

The expectations of the stakeholders play a significant role in the ESG integration, with investors, consumers and regulators requiring more accountability and transparency. An international survey has shown that 88% of investors rank ESG information in terms of measuring risk and expansion possibilities, which have an impact on capital distribution (Amel-Zadeh & Serafeim, 2018). Financial risks become even more intimidating to non-compliant firms due to regulatory pressure, including carbon pricing, where the net income is likely to be penalised by 5-7% in high emissions industries (Whelan et al., 2021). A stakeholder-oriented attention to material issues in ESG leads to optimality in the use of resources, with the material issue-prioritisation leading to a 4-6% increase in financial returns in firms (Khan et al., 2016).

The integration of ESG is also promoted by the market trend, including the emergence of impact investing and green bonds. Green bonds have become a billion-dollar industry, and companies can have access to sustainable projects financing at a low cost (Busch et al., 2015). These movements portray a larger momentum of sustainability, and ESG-oriented companies are at an advantage in satisfying stakeholders and tapping into new financial opportunities.

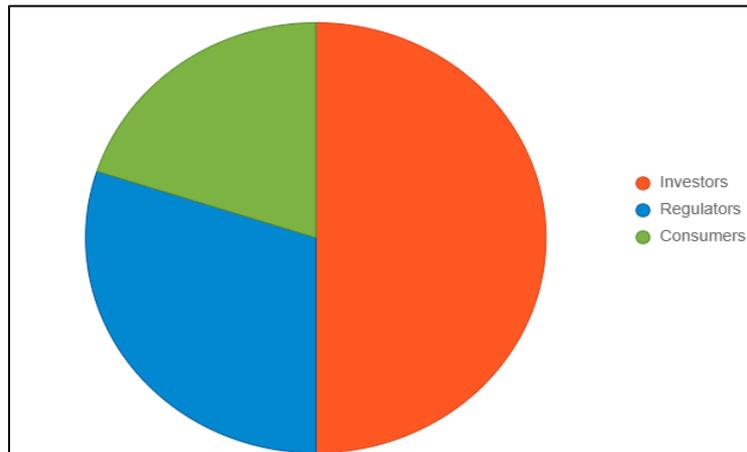


Figure 3 Stakeholder Influence on ESG Integration

5. Discussion

The incorporation of the principles of Environmental, Social and Governance (ESG) in financial strategy constitutes a revolutionary change of face in financial management, putting profitability in line with social and environmental aspirations. The findings of this systematic literature review, grounded on 20 pre-chosen sources, attest that ESG integration improves the financial performance, reduces risk, and supports the needs of stakeholders, yet there exist non-negligible challenges that need to be effectively addressed. It is based on the synthesis of these findings, their implications, and generalisation in the context of sustainable finance, explaining the phenomena based on empirical and theoretical pieces of the literature that are reviewed.

5.1. Financial Performance and Mechanisms

The results show four important mechanisms, including strategic decision-making, shareholder influence, risk management, and financial performance measures, in the implementation of ESG principles into the financial strategies. Having the priority focus on material ESG issues in strategic decision-making leads to better financial performance as high-sustainability companies can generate 4.8% higher returns on assets than those with lower sustainability (Eccles et al., 2014). This encompasses the stakeholder theory that focuses solely on creating a balance among the interests of various stakeholders in order to create value in the long term (Clark et al., 2015). The priority of material ESG issues, which has already been demonstrated by Khan et al. (2016), encourages the role of industry-specific strategies so that firms that prioritise expected environmental, social, and/or governance factors perform better than their generically oriented companies by as much as 6% in the stock returns.

Shareholder interaction is then one of the most effective emergent tools to minimise downside risk, with a 7% decrease in stock volatility with successful ESG-based engagements (Hoepner et al., 2024). This indicates that the active ownership not only puts the corporate practices and the expectations of the investors on the same line but also stabilises the financial performance, which reinforces the importance of governance in the financial strategy (Dimson et al., 2015).

Another essential mechanism is risk management that uses the ESG to respond to environmental and social risks. As an example, the risk of credit reduction due to strong employee relations is 12 percentage points (in terms of default probability), and the environmental initiatives help decrease the regulatory risks playing a role in reducing the risk premiums by 2 to 3% (Bauer et al., 2009; Giese et al., 2019). These results show that ESG integration is conducive to resilience, which is an important aspect in turbulent markets.

Its effect is further reinforced by the introduction of an ESG into financial performance analytics, with high-ESG companies enjoying a 1-2 lower cost of capital and 3-5 higher firm valuation (Clark et al., 2015; Minutolo et al., 2019). These advantages are enhanced by transparently reporting ESG, especially in indexes such as the S&P 500, which will help to generate investor confidence and better market sentiments. Moreover, these mechanisms collectively show that the ESG should not be a marginal factor but rather a central part of financial strategy and cannot be disregarded as it is in conventional wisdom, which emphasises short-term profits at the expense of long-term survival.

5.2. Positive Economic and Business Strategies: Finances

Financial returns on ESG integration can be huge and can include cost savings, easier access to capital and better stock performance. To a certain extent, they increase profitability by up to 15% through operational efficiencies achieved via energy-saving technologies, etc (Zhou 2022). It is more applicable in such a resource-intensive industry, where environmentally friendly practices turn into real financial benefits. The financial flexibility of ESG-oriented companies is also boosted by the possibility that a significant portion of the capital required will be sourced by a pool of \$35 trillion of sustainability-focused investors (Kräussl et al., 2024).

An effective framework that can be used to estimate these benefits is Return on Sustainability Investment (ROSI), that demonstrates how sustainability activities yield returns in terms of cost savings (e.g. potentially leading to \$10-\$20 million per year in waste savings) and new revenues (e.g., potentially leading to 5-10 percent increase in customer retention) (Atz et al., 2021). These results break the myth that ESG undermines profitability, and instead make it a source of competitive advantage. This is also supported by a 4.8% increase in stock returns that were witnessed in companies with strong CSR measures, implying that integrating ESG can deliver shareholder value on the one hand and societal objectives on the other hand (Flammer, 2015).

Strategically, the benefits presuppose that the companies will have to integrate ESG into their central business instead of considering it a part of due diligence. In the S&P 500, ESG disclosures positively correlate with the financial performance, indicating that transparency is a key to attracting investor confidence (Minutolo et al., 2019). Nonetheless, companies should focus on material ESG concerns in order to maximise their financial gain as non-material actions give them only diminishing returns (Khan et al., 2016). This will demand a sophisticated consideration of risk and opportunity assessment in industry and an ESG undertaking that is money-wise and socially viable.

5.3. Challenge and Barriers

Even though it has numerous benefits, ESG integration is struggling with several challenges that need to be overcome to realise the best out of it. It is unclear to the investors, and the decision-making is complicated by the divergence in ESG ratings among the big rating agencies; the correlation coefficients can reach 0.4-0.6 (Berg et al., 2022). This collective confusion will cast doubt upon the ESG metrics, which will require standardised frameworks to be put in place to achieve consistency and reliability. Another hindrance is the short-term expenses of ESG activities that would add 5-10% of the expenses in the first years, which are important to smaller companies that have limited resources (Busch et al., 2015). This conflict between the immediate financial value and the future financial value needs to be addressed with cautious financial planning to be able to sustain the support of the stakeholders.

An additional challenge to ESG integration is contextual factors, which include digital transformation and geographic diversification. Digitally mature companies notice a 10% increment in ESG-financial performance coherence than their less digitally mature counterparts in decision-making (Li et al., 2023). Nonetheless, the ESG advantages may decrease due to geographic diversification as multinational companies have to deal with different regulations in different regions, which minimises financial returns by 2-3% when highly diversified (Duque-Grisales & Aguilera-Caracuel, 2021). These results indicate that companies should focus their ESG policies and actions specifically on their business and geographical locations, use technology to provide greater visibility and navigate around regulatory challenges.

5.4. The Behaviour of the Stakeholder and the Market Trends

One of the sources of ESG integration is stakeholder expectations, as 88 per cent of investors value ESG information in risk management and possible growth forecasts (Amel-Zadeh & Serafeim, 2018). The financial risks of regulatory

pressures, i.e., carbon pricing, imply the financial risk of penalties, which cut net income by 5-7% in highly emitting industries (Whelan et al., 2021). That is why it is necessary to have proactive ESG to reduce compliance expenses and be competitive. Resource allocation is also made efficiently with stakeholder-driven focus on material ESG issues, and firms that focus on material issues have a 4-6 percentage increase in their financial returns (Khan et al., 2016).

The sustainable finance segment has become more pronounced with market trends, including the \$1 trillion green bond market, providing viable funding options to firms to cover their ESG activities at affordable rates (Busch et al., 2015). These tendencies demonstrate the increase in the correlation of financial policies with social aims and purposes; the ESG-oriented companies have a better chance to take advantage of new opportunities. Nevertheless, the success of such approaches is conditional on eliminating rating contradictions and the possibility of ensuring the financial feasibility of ESG measures, since when investors lose trust in credible and consistent metrics, none of the above strategies work (Gillan et al., 2021).

5.5. Broader Implications and Future Considerations

Findings are quite important in terms of theory and practice. Theoretically, they support the stakeholder theory by showing evidence that ESG integration has generated shared value to the investors, workers and the community, thereby challenging the shareholder-centred model (Clark et al., 2015). In practice, they indicate that companies should incorporate ESG into their strategy and make the most of the financial and social benefits of information analytics and involvement of stakeholders (Li et al., 2023). The emergence of sustainability in finance, including green bonds, also presents a chance to integrate financial strategies with pursuing ESG objectives, although it will require firms struggling with temporary costs to induce investor demand to be sustained (Busch et al., 2015).

In the future, the inconsistencies in ESG ratings need to be addressed so that investor confidence can be conscious, along with facilitating a scaling process. Digital transformation is one of the areas that may help this because improving the transparency and standardisation of ESG data will become possible (Li et al., 2023). Moreover, the global nature of operations definitely poses a challenge to organisations to optimise their solutions toward achieving the desired financial outcomes, which opens up a higher involvement of ESG strategies and their modifications to fit into the regional context (Duque-Grisales & Aguilera-Caracuel, 2021). With the ever-changing expectations of stakeholders, ESG integration is set to be a dynamic and critical element of financial strategy, which generates sustainable profitability in the growing, complex world of business.

6. Conclusion

Implementation of Environmental, Social, and Governance (ESG) into financial strategy is currently one of the most critical shifts in the history of corporate finance in the context of profitability that meets the sustainability and social needs. The synthesised evidence of the reviewed literature indicates that integrating ESG improves financial performance based on processes, including strategic decision-making, shareholder outreach, risk management, and better financial indicators and generates such benefits as cost reduction, an increase in market values and supply of money by obtaining a \$35 trillion pot of sustainability-focused capital. Notably, companies with a focus on material ESG concerns have generated up to 6% stock returns more, while ESG in credit reduces the stock by 7% and its volatility and 12% stock returns of credit risk. Nevertheless, the different ESG ratings with correlations ranging from 0.4 to 0.6 and the short-term expenses of 5-10 per cent demonstrate the necessity of metric stabilisation and a strategic approach.

The pressure created by the investors and regulators to meet the stakeholder expectations also reveals the importance of transparency and accountability: non-compliant companies will be penalised, and the net income will decrease by 57% in the high-emission industry. With the evolution of the market reflected by the trends (e.g., a \$1 trillion green bond market) towards sustainable finance, companies are required to embrace a new digital transformation and employ individualised approaches to disrupt the obstacles and capitalise on the financial and social potential of ESG. Finally, the topic of ESG integration is no longer a trend but a strategic necessity of companies that want to achieve sustainable profits and stability in an increasingly complicated environment.

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