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RESPONSIBLE FIRMS: CSR, ESG, AND GLOBAL SUSTAINABILITY

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PART I

AN OVERVIEW: CONCEPTS AND MEASUREMENTS

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CHAPTER 1

RESPONSIBLE FIRMS AND GLOBAL SUSTAINABILITY: TOWARD AN INTEGRATED FRAMEWORK

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ABSTRACT

The apparent contemporary corporate model is that of a “responsible firm” – a firm that pursues not only profit and shareholder return but also considers the concerns and interests of its social and environmental stakeholders. Research on corporate social responsibility (CSR), investor recognition via environmental, social, and governance (ESG) issues, and long-term sustainability has developed into an established field of study. We attempt to clarify the terminologies and models of this field by conducting a brief review of the existing work and suggesting an integrated conceptual framework for CSR, ESG, and sustainability in a domestic and global context. We suggest that externality and temporality are the drivers of this integrated framework.

Keywords: Sustainability; CSR; ESG; externality; temporality

JEL codes: M14, M16, G34

1. INTRODUCTION

The purpose of a corporation has been the subject of debate for decades. Traditionally, the dominant view argues that a firm's sole responsibility is to maximize profits for its shareholders (Friedman, 1970). This perspective emphasizes that corporations exist within a free market system, and their primary function is to generate financial returns for shareholders who invest capital. This focus on profits and shareholder returns incentivizes efficiency and innovation, driving economic growth and prosperity.

However, many now challenge this view and argue that corporations have a broader purpose that extends beyond profit maximization (Business Roundtable, 2019; Jensen, 2001). This perspective highlights the interconnectedness of businesses with society and the environment. Corporations can be seen as having a responsibility to these stakeholders (Donaldson & Preston, 1995). Corporations rely on a healthy and educated workforce, as well as stable communities where they operate; investing in employee well-being, fair wages, and supporting local communities fosters loyalty and creates a positive social impact. Business activities can have a significant impact on the environment. Thus, sustainable practices, such as reducing waste and pollution, are not simply good for the planet, but can also lead to long-term cost savings and improved brand reputation of the firm (Joly, 2021).

The contemporary global model is that of a “responsible firm” – a firm that not only pursues profit and shareholder return but also considers the concerns and interests of its social and environmental stakeholders. Thus, research on CSR and/or, its investor-specific dimension, ESG, has developed into an established field of study.¹ A related development from a policy perspective is the notion of sustainability, which evolves into the same field because sustainability overlaps with CSR and ESG. However, despite significant research on these areas in business and economics, the basic results remain mixed and fragmented. Starks (2013) argues that the differences between investors' and managers' motivations, along with confused terminologies and complex models in sustainable finance, contribute to misunderstandings. In this work, we attempt to clarify the terminologies and models in responsible firms and sustainability by conducting a brief review of existing work and by suggesting a conceptual framework for CSR, ESG, and sustainability. We also consider the case of multinational enterprises (MNE) that contextualize the discussion from domestic to global economy. We do not attempt to be exhaustive in this review, only to sketch an overview. However, we do make an initial attempt to combine the fragmented pieces of corporate, investor, and societal perspectives on CSR, ESG, and sustainability into an integrated framework of responsible firms and global sustainability.

2. SUSTAINABILITY, CSR, AND STAKEHOLDER MODELS

Various researchers have explored how and when firms address the concerns of stakeholders (e.g., Carroll, 1991; Freeman, 1984) and how firms differ in balancing interests between shareholder and social stakeholders, such as communities

and employees – the “S” (social) in ESG (e.g., [Clarkson, 1995](#)). By building trust with stakeholders and fostering a positive brand image, firms can attract and retain talent, improve customer loyalty, and maintain a competitive advantage. Simultaneously, environmental concerns impact firms, and combined with studies in economics and environmental science, this led to research on the “E” (environmental) in ESG. In this section, we discuss these streams of research on social and environmental sustainability with CSR activities as primary tools. Later, we will discuss ESG as an instrument to address market recognition and investor perspectives.

The definition of sustainability most frequently cited originates from the [UN World Commission on Environment and Development \(1987\)](#), which defines sustainable development as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs.”

Regarding specific outcomes, there are three types of sustainability: corporate sustainability, social sustainability, and environmental sustainability. *Corporate sustainability* is the effect of a firm’s CSR activities, or ESG ratings, on its own sustainability. This includes enhanced reputation and brand value, reduced risks and costs, improved access to capital, innovation, and long-term growth as well as the likelihood of the firm’s legitimacy and survival. This can be estimated by predicted proxies of firm bankruptcy and financial stress and the firm’s reputation, legitimacy, and social acceptability.

The other two concepts of sustainability address the effects on CSR contributions to society and the earth. *Environmental sustainability* (E) denotes concerns regarding reduced greenhouse gas emissions; resource conservation, efficiency, and innovation; and climate change mitigation. *Social sustainability* (S) pertains to improved employee relations and stronger community relationships including philanthropy. It should be stressed that some business functions such as supply chain management (SCM) may involve both social and environmental sustainability, as these influence the implementation of responsible sourcing practices and supplier codes of conduct, as well as the promotion of ethical labor practices (S) and environmental sustainability (E) through the SCM process.

The academic field has developed related constructs that describe firms’ social engagement to achieve sustainability, with similar but slightly different emphasis, such as corporate social performance ([Clarkson, 1995](#)), the triple bottom line ([Elkington, 1997](#)), corporate citizenship ([Matten & Crane, 2005](#)), as well as corporate social responsibility ([Carroll, 1999](#)), and others. CSR, in particular, refers to voluntary organizational practices that seek to improve social and environmental sustainability ([Carroll, 1999](#); [McWilliams & Siegel, 2001](#)). While each construct was developed from varied backgrounds, the overarching notion that moves the model of firms from a shareholder-centric view to that of the stakeholders pertains to how various stakeholder perspectives can be harmoniously incorporated into corporate operations and strategies.

[Carroll \(1999\)](#) defines CSR as a firm’s voluntary actions and initiatives to address social and environmental issues beyond their legal requirements. CSR can include philanthropic activities, community engagement, ethical sourcing, sustainability programs, and employee volunteer programs, among others. CSR

is often viewed as a way for companies to build and maintain their reputation, mitigate risks (Godfrey, 2005; Godfrey et al., 2009; Kim et al., 2021), improve stakeholder relationships, and contribute to the well-being of society and the environment. Underlying motivations for CSR initiatives are numerous, including instrumental, relational, and moral motivations from individuals, organizations, and institutions (e.g., Aguilera et al., 2007; Aguinis & Glavas, 2012).

3. ESG AND INVESTOR PERSPECTIVES

Environmental, social, and governance factors are used by investors to evaluate companies' long-term sustainability and potential risks and opportunities. The term "ESG" was coined to define a series of issues to be integrated into investment analysis and was first devised in the 2004 report by financial institutions from multiple countries in response to a call from Kofi Anon, Secretary-General of the United Nations (for a historical summary, see Pollman, 2022; and IFC website). The report notes that the goal is for a "better inclusion of ESG factors in investment decisions" and that "companies with better ESG performance can increase shareholder value by better-managing risks related to emerging ESG issues, by anticipating regulatory changes or consumer trends, and by accessing new markets or reducing costs." A recent development of ESG posits that it is a mainstream practice rather than a niche subfield (Edmans, 2023) and clarifies the term by differentiating investment approaches, investor preferences, and expected returns with a *value* versus *values* framework, e.g., financial value vs. multiple manager preferences (Starks, 2023). In her presidential address, Starks (2023), president of the American Finance Association, posits that ESG investments are a way to pursue nonpecuniary motivations with a willingness to accept lower returns from a *values* perspective, whereas ESG investments can also be employed by sole financially oriented investors from a *value* perspective.

Reflecting the investor focus, many authors have examined the impact of ESG investments on firm alpha, the abnormal rate of return in relation to a benchmark after adjustment for risk. A study by Khan et al. (2016) shows that firms improving on material ESG issues significantly outperform firms with poor ratings. In contrast, addressing the issue of correlated omitted factors, Ahn et al. (2024) report that the materiality portfolio does not outperform, once accounting for its exposure to profitability and growth factors. Attig et al. (2024) indicate that firms oversell CSR by hyping up their CSR narratives at year-end earnings conference calls.

Among the most examined questions in the literature is the relationship between CSR/ESG and financial performance (e.g., Margolis & Walsh, 2003; Orlitzky et al., 2003). For example, several studies support the agency-based perspective that CSR/ESG enhance managers' utility (e.g., Benabou & Tirole, 2010) even when it does not produce market valuation (Di Giuli & Kostovetsky, 2014; Masulis & Reza, 2015). However, most studies document a positive association between CSR/ESG and the financial performance of the firm (e.g., Borghesi et al., 2014; Flammer, 2015; Gao & Zhang, 2015; Liang & Renneboog, 2017),

suggesting mechanisms such as an increase in tangible or intangible assets or a decrease in the cost of capital.

Broadly, ESG (or CSR) is fundamentally related to the notion of stakeholder theory (Donaldson & Preston, 1995), consistent with not only shareholder profits but also the interests of social and environmental stakeholders. Given the identity and context of stakeholders and firms, applications vary. CSR pertains to a firm's voluntary social and environmental practices, while ESG focuses on the evaluation of these voluntary practices by market or investors aiming to manage risks pertaining to ESG. Recently, there has been some skepticism about the overselling of CSR (Attig et al., 2024). Nevertheless, both CSR and ESG are instruments that highlight the importance of firms taking responsibility for their impact on society and the environment and for being transparent about their actions and performance (Campbell, 2007; McWilliams & Siegel, 2001).

4. TEMPORAL ORIENTATION OF S VS. E

In management and finance research within the CSR and ESG domain, little attention has been directed to how the social (S) and environmental (E) components of ESG distinctly contribute to intergenerational and intragenerational equity, respectively. Although the temporal dimension has been explored in CSR/ESG research (e.g., Flammer & Bansal, 2017; Slawinski & Bansal, 2015), it is seldom linked to distinct social and environmental dimensions and their potential conflicts. A recent review of CSR and ESG research (Gillan et al., 2021) shows that the majority of sustainability studies utilize CSR or ESG as a singular construct and measure, masking the important differences between the two.

Within the ESG/CSR framework, social (S) and environmental (E) corporate activities differ in two respects. One is the difference in intertemporal context. S prioritizes intragenerational equity, emphasizing fair distribution of resources and equal opportunities for people within the present generation. This includes addressing issues such as fair labor practices, diversity and inclusion initiatives, or addressing social issues impacting specific communities within a given time period. The social dimension generally addresses primary stakeholders such as employees, customers, suppliers, and communities, which helps develop intangible and tangible assets, increasing shareholder value (Hillman & Keim, 2001).

On the other hand, E primarily focuses on intergenerational (i.e., intertemporal) equity, concerned about the responsible stewardship of natural resources and the mitigation of climate change impact to ensure a sustainable outcome for future generations. Intergenerational equity involves organizational actions, such as reducing carbon emissions, preserving biodiversity, and developing renewable energy sources to safeguard the environment for the future. The different time frame between S and E is supported by findings that more long-term oriented firms demonstrate greater E performance than S engagement (Choi et al., 2023).

Despite some attempts about the potential tradeoffs between S and E strategies (Beckmann et al., 2014; Hahn et al., 2015), only the surface has been sketched. Fundamentally, this line of inquiry over time and space is a matter of

intertemporal economic choice (Loewenstein & Thaler, 1989) and its application in sustainability theory and management remains an open issue.

5. ENVIRONMENT AS A STAKEHOLDER WITH EXTERNALITY

Traditionally, businesses have not viewed the environment as a stakeholder. However, a growing understanding of our interconnectedness with the natural world necessitates a broader perspective. The environment is a crucial “stakeholder,” whose concerns must be incorporated into corporate decisions now given the intertemporal gaps between emissions and outcomes. This is also because of the notion of externality, which does not enter typical corporate cost and benefit analysis.

The theory of *externality* explains how a company’s activities can create costs or benefits for society, which are not reflected in market prices. Jiang et al. (2023) examine the negative externalities of mandatory ESG disclosure through the lens of regulatory salience and report that mandatory disclosure may induce trade-offs of different ESG goals by prioritizing more conspicuous ESG practices at the cost of trivializing other longer-term issues. Moreover, aside from the disclosure effect, businesses often generate negative environmental externalities such as pollution, resource depletion, and climate change. The negative externalities must be included in cost-benefit analysis of all corporate investments and operations, as well as their impacts on social and environmental sustainability in both national and supranational policy debates.

Many challenges are related to environments, some expected and some unexpected. Conflict resolutions are key to the successful navigation through the vagaries and uncertainties of the future – both horizontally across divergent interests and stakeholders and vertically across agents and institutions over time. To explain the dynamic business decisions pertaining to environments, theories of institutional change (North, 1990) and intertemporal choice (Loewenstein & Thaler, 1989) seem relevant as foundational pieces before application.

6. GOVERNANCE (G) AND INSTITUTIONS

Parenthetically, another ESG factor pertaining to social environmental practices is “G” (governance). The United National Environment Programme Finance Initiative, in its original report, provides the rationale for including G as part of ESG by noting: “Sound corporate governance and risk management systems are crucial prerequisites to successfully implementing policies and measures to address environmental and social challenges.” The governance (G) factor functions as a foundation for firms, which underlies all corporate decisions including the environmental (E) and social (S) initiatives.

Various scholars have documented the effects of G on the firm, in both CSR and ESG domains. To wit, board directors’ gender (Brammer et al., 2009;