

CONCEPTUAL FOUNDATIONS OF ESG INTEGRATION IN MODERN BUSINESS MODELS

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Abstract: *The ESG criteria have shifted decisively from the periphery of investment theory to the centre of corporate strategy, regulatory design, and academic inquiry. Yet the conceptual architecture underlying ESG integration remains imprecisely theorized. The framework is widely applied in practice, whereas its theoretical foundations remain subject to ongoing academic debate. This paper examines the intellectual underpinnings of ESG integration within modern business models, tracing its origins across stakeholder theory, institutional economics, and strategic management, while mapping the mechanisms through which ESG factors generate (or fail to generate) long-term enterprise value. Drawing on an integrative review of theoretical and empirical literature, this study articulates a multi-dimensional framework that distinguishes strategic, operational and reporting dimensions of ESG adoption. The study critically examines structural challenges including rating divergence, greenwashing, and the time-horizon mismatch between genuine sustainability transformation and the temporal logic of contemporary capital markets. It contributes a conceptually coherent account of ESG integration suited to the demands of contemporary scholarship and business practice alike.*

Keywords: *ESG integration, stakeholder theory, double materiality, sustainable business models, value creation, corporate governance.*

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1. Introduction

Something has shifted in how the relationship between business and society is understood – not merely in activist circles or policy documents, but in the analytical frameworks that investors, strategists, and regulators bring to enterprise evaluation. ESG criteria once limited to the terrain of ethical investment, now permeate capital allocation decisions managing considerable amounts of financial resources worldwide, inform mandatory disclosure regimes across major jurisdictions, and increasingly determine the terms on which enterprises access talent, supply chains, and financial markets. The convergence of these forces has happened faster than most commentators predicted.

This rise has been rapid, and its conceptual foundations have not always kept pace with its practical spread. The term ESG entered institutional discourse formally through the 2004 report “Who Cares Wins”, developed under a UN Global Compact-led, multi-institutional financial sector initiative (United Nations Global Compact, 2004), but the ideas it organises draw on decades of prior theoretical work. This prior theoretical work is related to stakeholder relationships, corporate governance, institutional pressures, and the social embeddedness of economic activity. The ESG framework has been widely taken up in practice, even as academic debate continues to explore its conceptual scope. The difference in emphasis between application and theory is an important context for understanding its development. Without a clear account of what ESG integration actually means – how it creates value, through which mechanisms and under what conditions – the concept risks

dissolving into rhetorical performance: the right language spoken over business models that have not fundamentally changed.

This paper addresses three connected questions. First, what are the theoretical foundations from which ESG integration draws its conceptual coherence? Second, through which mechanisms do ESG factors translate into enterprise value? Third, what structural challenges prevent integration from advancing beyond disclosure?

The paper proceeds as follows. The literature review provides an overview of the theoretical literature situating ESG within its intellectual lineage. The following section describes the methodology applied. The results and discussion section develops the integrative framework and examines value creation mechanisms and structural challenges. The paper presents the conclusions in its last section.

2. Literature Review

Theoretical foundations

ESG integration does not emerge from a single intellectual tradition. Its conceptual coherence derives from the convergence of several distinct theoretical strands, each contributing to a dimension that the others alone cannot provide.

One of the most influential challenges to the shareholder-centered models of the firm, that ESG implicitly contests come from Freeman's (1984) stakeholder theory. The proposition that firms are embedded in webs of obligation extending to employees, communities, suppliers, customers and the natural environment, and that managing these relationships well is not merely an ethical preference but a strategic necessity. Freeman's framework reoriented corporate purpose away from Friedman's (1970) narrow formulation that suggested that the social responsibility of business is to increase its profits. It moved towards a pluralistic account of value creation that ESG frameworks operationalise, imperfectly but recognisably. The difference between these two positions is not only a matter of wording; it reflects differing views on where corporate accountability ultimately lies.

Institutional theory, particularly DiMaggio and Powell's (1983) account of isomorphic pressures, explains why firms adopt ESG practices even when the financial case is ambiguous or contested – a phenomenon that purely rational choice models cannot adequately account for. Coercive pressures, rooted in regulatory requirements, compel adoption when law mandates it. Mimetic pressures drive adoption when firms emulate industry leaders navigating uncertain environments. Normative pressures operate through professional standards, industry associations, and educational institutions that collectively shape what responsible management is understood to mean. These three mechanisms explain the breadth of ESG adoption across sectors and geographies far more convincingly than financial incentives alone.

The resource-based view (Barney, 1991) adds a further analytical layer, specifically the ESG capabilities. These capabilities, which include organisational routines, measurement systems, stakeholder networks and governance structures that support genuine sustainability integration can also constitute sources of sustained competitive advantage when they are valuable, rare, difficult to imitate and non-substitutable. This reframing moves ESG from the domain of compliance and ethics into the domain of strategic management, with significant implications for how integration should be designed, resourced, and evaluated.

Mayer's (2018) concept of purposeful capitalism extends these arguments to questions of corporate purpose itself. The EU's Corporate Sustainability Reporting Directive (CSRD) gives them regulatory force for its operationalisation of double materiality: the simultaneous assessment of how ESG factors affect enterprise value and how enterprise activity affects society. It represents a conceptual expansion of considerable importance.

Empirical evidence on ESG and performance

The empirical literature on ESG and financial performance is voluminous and on balance, broadly supportive of a positive relationship – even though with qualifications that careful reading reveals. The meta-analysis by Friede et al. (2015), synthesizing over 2000 primary studies, found that approximately 90% reported a non-negative ESG performance relationship, with the majority positive. That headline finding, however, masks considerable heterogeneity. Subsequent syntheses highlight that results vary substantially depending on methodology, ESG measurement and investment approach, with no consistent evidence of systematic outperformance (Atz et al., 2023).

Eccles et al. (2014) provide the most cited longitudinal evidence – high sustainability companies significantly outperform low sustainability peers on both stock market and accounting metrics over a long-term horizon. The evidence also indicated that high sustainability firms had more developed stakeholder engagement practices and were more likely to have longer term oriented investors. Khan et al. (2016) refine the question – performance on issues that are financially material to a given industry predicts future performance, while performance on immaterial issues does not. This finding suggests that the ESG-financial performance relationship is not generic but contingent – contingent on the relevance of specific ESG factors to specific business models or competitive contexts. The endogeneity problem, whether better-managed firms simply tend to score higher on both ESG and financial metrics remains unresolved and limits the strength of causal claims that correlational evidence can sustain.

Research gap

Despite the volume of ESG literature, theoretical fragmentation still persists. The three pillars are studied largely in isolation. The mechanisms connecting strategic intent, operational practice, and reporting outcomes are underspecified. At the same time, double materiality lacks systematic theoretical treatment in the management literature, despite its regulatory codification. This paper addresses those gaps by developing an integrative framework that brings these dimensions into coherent relation.

3. Methodology

This paper employs an integrative literature review methodology. The objective is not to conduct a systematic review in the technical sense, but to provide a theoretically guided synthesis and develop a conceptual framework in a domain where empirical research has proliferated faster than theoretical integration.

The literature base spans four decades of scholarship across strategic management, institutional economics, finance and sustainability science. Sources were selected on criteria of theoretical influence, empirical rigour, methodological transparency and relevance to the free analytical questions that organize the paper. Priority was accorded to peer reviewed articles in leading management and finance journals supplement by

regulatory documents, specifically the EU CSRD, and the European Sustainability Reporting Standards (ESRS), that constitute the primary institutional codification of ESG and sustainability concepts. Theoretical constructs were evaluated for internal consistency, explanatory scope and compatibility with observed patterns of ESG adoption across firm types and institutional contexts.

The analytical output takes three forms: a multidimensional integration framework distinguishing the strategic, operational and reporting dimensions of ESG adoption; a typology of five value creation mechanisms through which ESG performance translates into enterprise value; and a structured analysis of three structural challenges that prevent genuine integration from being reduced to disclosure performance. The framework is intended both as a conceptual contribution in its own right and as a foundation for subsequent empirical research employing enterprise-level surveys, longitudinal panel data, or comparative regulatory analysis.

4. Results and Discussion

The literature supports a conceptualisation of ESG integration operating across three analytically distinct but operationally interdependent dimensions: strategic, operational, and reporting. Genuine integration requires coherence across all three dimensions. The absence of any one dimension tends to undermine the credibility and effectiveness of the others – a proposition empirically observable in the divergence between companies that produce extensive ESG reports while not fully embedding ESG values into operational decisions, and those where sustainability is woven into the logic of business across all levels.

The strategic dimension concerns how ESG considerations are embedded in corporate purpose, long-term goal setting, and competitive positioning. Companies that define their purpose in terms of creating value for all stakeholders – rather than treating ESG as a constraint on the primary objective of shareholder return – create normative and organisational foundation on which integration at lower levels can be built. Without this anchor, ESG programmes tend to remain peripheral – specifically responsive to external pressure, overall episodic in application and reversible when performance pressures intensify. In the strategic dimension, the relationship between ESG and competitive advantage more visible. Porter and Kramer's (2011) shared value framework usefully argued that social and environmental challenges can be reframed as sources of competitive opportunity and innovation, rather than costs.

The operational dimension is where most ESG value is created or destroyed. Not in disclosure documents, but rather in the accumulated decisions of supply chain managers, product engineers, HR directors, and facilities teams. Here the tensions between short-term cost pressures and long-term value creation are most acute, and the absence of appropriate measurement systems most seriously impedes genuine integration. Energy and resource management, labour standards enforcement across supply chains, waste and water stewardship – these require investment in monitoring, systems and accountability that carries upfront cost and delivers returns on a horizon that quarterly reporting does not readily capture.

The reporting dimension concerns measurement, disclosure, and independent assurance. Standardised frameworks, such as GRI, SASB, TCFD or ESRS, have substantially improved disclosure comparability, though gaps still persist across jurisdictions and sectors. Double

materiality, codified in the CSRD and operationalised through ESRS, is the reporting dimension's most consequential development. By requiring disclosure of both financial materiality and impact materiality, the double materiality enacts a pluralistic conception of corporate accountability extending far beyond investors to encompass all affected stakeholders. Table 1 summarizes the integration framework developed in this paper. ESG integration is conceptualised as operating across three analytically distinct but operationally independent dimensions, and effective integration requires coherence across all three.

Table 1. Dimensions of ESG Integration in Modern Business Models

Dimension	Analytical role	Core management focus	Theoretical anchors	Risk of decoupling
Strategic	Defines the firm's purpose and long-term ESG orientation	Corporate purpose; stakeholder value creation; alignment of ESG long-term priorities with business model and competitive positioning	Freeman (1984); Mayer (2018); Porter & Kramer (2011)	ESG framed rhetorically but not embedded in organisational priorities. Reactive and vulnerable to reversal under short-term performance pressure
Operational	Embeds ESG into capabilities and business processes	Supply chain practices; workforce management, risk controls; resource efficiency; monitoring systems and incentives	Barney (1991)	Symbolic ESG commitments not translated into routines or resource allocation
Reporting	Externalises ESG through disclosure, comparability, and legitimacy	Double materiality assessment; alignment with global standards; third-party assurance; reporting transparency	DiMaggio & Powell (1983); Suchman (1995)	Disclosure-driven ESG: improved reporting quality with limited strategic or operational transformation

Source: Author's synthesis.

Value Creation Mechanisms

If ESG integration is to be understood as something more than a compliance requirement or reputational management exercise, a clear account of the mechanisms through which it generates enterprise value is essential. The literature identifies five distinct channels, each with a different risk-return profile and time-horizon. Genuine integration typically activates several channels simultaneously.

The first is risk mitigation. ESG management systematically addresses categories of enterprise risk that conventional financial analysis tends to underweight or ignore entirely: regulatory risk (the expanding perimeter of mandatory ESG requirements across jurisdictions), physical climate risk (the direct financial consequences of weather events, resource scarcity, and ecosystem disruption), and transition risk (the financial implications of decarbonisation policy, technology shifts and market reorientation). Carbon intensive assets face stranded asset exposure as emissions pricing tightens. Enterprises with poor labour practices face considerable litigation and reputational exposure. Governance failures correlate strongly with

fraud and misconduct. In this framing, ESG management could be perceived as advanced enterprise risk management applied to a broader and longer risk horizon – not a departure from shareholder value logic, but a more complete expression of it.

The second channel is cost reduction. Energy efficiency, waste minimisation, and water stewardship reduce operating costs directly and also measurably. As Luken and Saieed (2023) show, resource-efficiency measures related to energy, waste and raw materials lead to lower resource use and attractive payback periods, which refer to the time required for the financial savings generated by a resource-efficiency measure to cover its initial implementation cost. Their study therefore points to clear potential for operational savings.

The third is revenue enhancement. ESG positioning opens access to sustainability-premium market segments, public procurement conditioned on ESG performance and a growing universe of institutional clients that are facing their own mandatory ESG reporting obligations. There is also a focus on embedding sustainability criteria in supplier selection.

The fourth is capital access. Academic evidence suggests that credible green instruments can benefit from preferential pricing, especially when supported by external reviews, while voluntary sustainability disclosures and third-party assurance may also contribute to lower cost of capital (Dorfleitner et al., 2022; Martínez-Ferrero & García-Sánchez, 2017)

The fifth is human capital and organisational resilience. Firms with demonstrably strong social performance attract and retain talent more effectively, exhibit lower absenteeism and employee turnover, and demonstrate greater adaptability in conditions of operational disruption.

Structural Challenges to Genuine Integration

Acknowledging value creation mechanisms does not require ignoring the substantial obstacles that prevent ESG integration from transcending disclosure performance. Three deserve particular attention.

Rating divergence is the first. Berg et al. (2022) document a mean correlation of 0.54 between ESG ratings from major providers. This figure contrasts with the 0.92 correlation between credit ratings from Moody's and Standard & Poor's. The divergence reflects methodological differences in scope (what factors are covered), measurement (how they are quantified), and weighting (how factors are aggregated into composite scores). Its practical consequence is that ESG grounded investment and management decisions embed significant, frequently unacknowledged measurement uncertainty. However, recent developments in sustainability reporting standards showcase progress, with the ISSB standard and ESRS potentially improving disclosure consistency and comparability over time.

Greenwashing is the second. Its forms are varied and often sophisticated. Net-zero commitments unsupported by credible transition pathways, ESG fund labels applied to portfolios with negligible sustainability differentiation and environmental certifications that capture narrow metrics while ignoring broader impacts. What greenwashing shares across its manifestations is a strategic exploitation of information asymmetry between disclosers and audiences, corroding the institutional trust that the entire ESG enterprise depends on. Regulatory responses are still expanding, as reflected in initiatives such as the EU Green Claims Directive, the UK FCA's Sustainable Disclosure Requirements, the SEC's climate disclosure rules. At the same time, enforcement frameworks are still evolving, and the interaction between regulatory design and corporate compliance practices remains dynamic.

The third challenge, and perhaps the most structurally intractable, is the time-horizon mismatch. Genuine ESG transformation, such as decarbonising an energy system, rebuilding supply chains around human rights standards, closing persistent gender pay gaps or developing board diversity at industry scale – requires multi-decades commitment and investment. The institutional architecture of capital markets, however – quarterly earnings reports, fund manager tenures, benchmarking against short-horizon equity indices – creates systematic and powerful pressure against the long-horizon thinking that sustainability transformation demands. This is not a problem of intentions – it is a structural misalignment between the temporal logic of ecological and social change and the temporal logic of contemporary financial markets. Resolving it requires institutional innovation in fiduciary duty frameworks, executive incentive design and benchmarking conventions.

5. Conclusions

ESG integration has arrived at a peculiar moment: widely adopted in language, unevenly implemented in practice, periodically under-specified relative to its practical ambition. This paper has attempted to address the theoretical deficit by tracing ESG integration's intellectual foundations across stakeholder theory, institutional economics, and strategic management; by articulating a multidimensional framework that distinguishes the strategic, operational and reporting dimensions of adoption and by systematically examining the value creation mechanisms and structural challenges that determine whether integration is genuine or performative.

Three conclusions follow. First, ESG integration cannot be adequately understood through a single theoretical lens. Its analytical depth emerges from the convergence of stakeholder theory, institutional theory, and the resource-based view – each contributing a dimension that the others alone cannot provide. Strategic purpose, operational practice and transparent reporting must cohere. Where they do not, ESG remains the surface phenomenon vulnerable to the pressures it nominally addresses. Second, the value creation case is real, multi-channelled, and strongest over long time horizons – but not automatic. It depends critically on integration depth. Enterprises that treat ESG as primarily a disclosure exercise will generate disclosure. Those that embed ESG into purpose, strategy, operations, and accountability systems will generate value in the long term.

Third, the structural challenges – rating divergence, greenwashing, and the time-horizon mismatch – are genuine and not fully resolved by existing regulatory or market mechanisms. Acknowledging them is not a counsel of pessimism but a condition of analytical integrity. The concept that deserves particular emphasis is the double materiality, which the CSRD has moved from academic discussion to legal obligation by requiring firms to account for their impact on the world, and not merely the world's impact on their financial position. It enacts a pluralistic conception of corporate accountability that stakeholder theory has long advocated. Whether mandatory disclosure translates into substantive behavioural change or produces a sophisticated compliance industry is an empirical question of considerable urgency for future research. Two directions seem most pressing: longitudinal studies tracking integration depth, as distinct from disclosure volume, against enterprise outcomes, and comparative institutional analysis examining how different regulatory materiality frameworks shape the quality and durability of ESG adoption across governance contexts.

The question that underlines this entire inquiry – whether modern business models can be durably restructured around environmental stewardship, social responsibility, and accountable governance – remains genuinely open. The conceptual foundations examined here suggest it is possible. Whether that possibility is realized depends on choices by managers, investors, regulators, and scholars that are still, consequentially, being made.

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