

## Mediating Role of Internal Control in the Relationship between ESG-Based Corporate Social Responsibility and Firm Financial Performance: Evidence from Pakistan

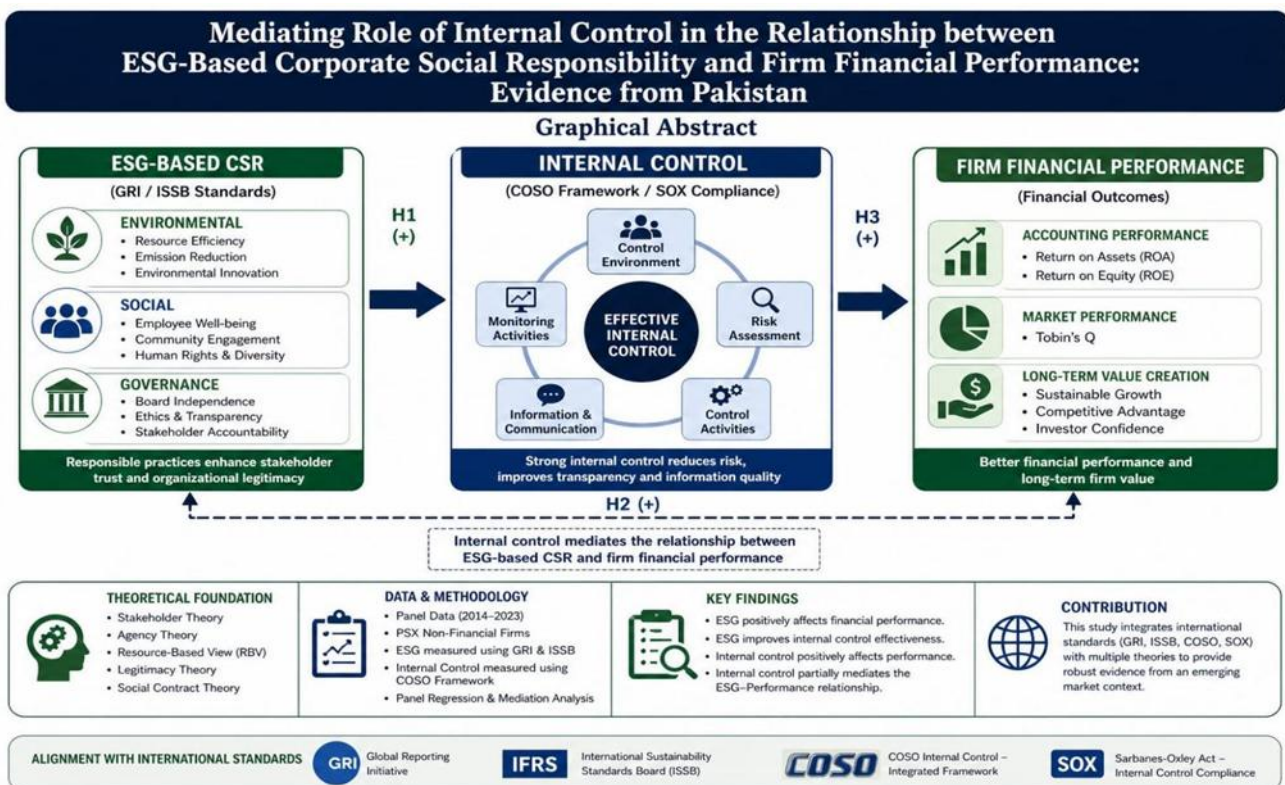
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### Graphical Abstract



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## Abstract

This research paper analyses the relationship between Environmental, Social and Governance (ESG)-based Corporate Social Responsibility (CSR) and company financial performance as a particular emphasis on the mediating role of internal control effectiveness when considering the relationship between the aforementioned variables in the context of the emerging economies. The study relies on sustainability and reporting procedures known to stakeholders around the globe including the Global Reporting Initiative (GRI) as well as the International Sustainability Standards Board (ISSB) to operationalize the notions of ESG-based CSR practices.

This study uses the strong econometric methods, such as panel regression model and mediation analysis, to test the validity of the direct and indirect relationship between variables using the use of a balanced panel dataset of non-financial firms listed on the Pakistan Stock Exchange (PSX) over a multi-year period. Under ESG performance, a content analysis in accordance with the international levels of disclosures, as well as in accordance with the internal control effectiveness in the COSO model, will be measured. The high financial performance is represented by the accounting performance measures (Return on Assets and Return on Equity) and the market-based measures (Tobin's Q).

The results show that the CSR which is based on ESG positively affects the financial performance of the firm both directly and indirectly through improved internal control systems. In particular, companies having a high CSR engagement show better governance systems, risk management, and transparency, which enhance the internal controls, and consequently the financial results. The critical role of an internal control in providing the mediation between sustainability efforts and value creation definitely reflects the critical role played by internal control as an internal control mechanism of governance that links the sustainability efforts and the value creation.

The research paper has contributions to the existing body of literature by presenting empirical evidence that encompasses the limited integration of ESG framework and internal control mechanisms in the literature, on a developing economy. It also provides useful implications to the managers and regulators of corporations along

with the international system of controls and control systems through focusing on the strategic significance of aligning CSR activities with internationally recognized standards and effective systems of internal controls. Moreover, the research supports the global sustainability goals as identified by the United Nations Sustainable Development Goals since it shows how responsible corporate practices can lead both financial performance and sustainable development.

**Keywords:** *ESG (Environmental, Social, and Governance); Corporate Social Responsibility (CSR); Internal Control Effectiveness; Firm financial performance; Corporate Governance; Emerging markets; Pakistan stock exchange (PSX); Sustainability Reporting; Global Reporting Initiative (GRI); International Sustainability Standards Board (ISSB).*

## **1. Introduction**

CSR has over the past years become increasingly structured and globally standard in the construct of a structured Corporate Social Responsibility (CSR) (Friede, Busch & Bassen, 2020; Gillan, Koch and Starks, 2021).

International reporting and sustainability standards of the Global Reporting Initiative (GRI) as well as the emerging disclosure requirements introduced by the International Sustainability Standards Board (ISSB) have reinforced this transformation in a strong fashion (IFRS Foundation, 2023; Eccles and Klimenko, 2021).

Although the role of ESG-based CSR in improving firm financial results is increasingly discussed as an important topic, empirical evidence regarding the role of ESG-based CSR in enhancing firm financial outcomes remains inconclusive, especially in emerging economies where the institutional environment is less developed; and where the system of governance is not as advanced (Alareeni and Hamdan, 2020; Khan et al., 2022).

According to previous research, CSR activities can positively impact financial performance by providing a positive image of the company, decreasing agency conflicts, and enhancing stakeholder trust; nevertheless, the underlying mechanisms

of how CSR turns into financial performance are understudied (Wang and Sarkis, 2021; Velte, 2022).

In this case, internal control systems are crucially involved in ensuring the efficiency of operations, the reliability of financial reports, and the adherence to regulatory requirements, especially when organized on the basis of globally accepted models, such as COSO and the Sarbanes-Oxley Act (SOX) (COSO, 2019; Doyle et al., 2020). Tight connection between ESG practices and the end result of firm performance can be strengthened by ensuring the presence of effective internal control systems that are not only capable of reducing any risk of financial misreporting but also enhance organizational transparency and accountability (Appiah and Chizema, 2021; Hsu et al., 2023).

Theoretically, the current study has to be based on several complementary points of view. According to the stakeholder theory, the firms that practice the approach of CSR based on ESG react better to the expectations of the stakeholders, which increases their levels of legitimacy and long-term success (Freeman, 1984; Harrison et al., 2020). Agency theory also assumes that effective governance and internal control systems minimize information asymmetry and management as opportunists and result in better financial performance (Jensen and Meckling, 1976; Mustesen et al., 2021). Likewise, the resource-based view (RBV) is an argument that asserts that ESG capabilities and good and strong internal control systems are valuable, rare, and imitable resources that increase the competitive advantage (Barney, 1991; Hart and Dowell, 2021). The concept that firms aiming to survive in competitive markets adopt CSR practices to endure the criticism of not meeting the expectations of society also receives support according to the legitimacy theory and social contract theory (Suchman, 1995; Deegan, 2020).

The measurement of ESG-based CSR relies on primary data with the help of structured instruments, and internal control effectiveness is estimated based on the COSO framework and SOX principles, with support of the secondary data that have been averaged over the last decade to ensure reliability and strength (COSO, 2019). Both accounting-based measures (mid Return on Assets (ROA) and Return on Equity (ROE)) and market-based ones (Tobin Q (Q)) are used to evaluate financial

performance. The control variables that include firm size, firm age, leverage and research and development expenditure are included to reduce omitted variable bias and render empirical results to be robust (Chen et al., 2022; Nguyen and Nguyen, 2023).

Even with growing interest in ESG and CSR, there is still a research gap in understanding how institutional weakness and problems in governance mediate the CSR-performance relationship in emerging economies such as Pakistan, where institutional weaknesses and governance challenges continue to prevail (Qureshi et al., 2022; Ali and Zhang, 2023). Thus, this research will be able to add to the literature by combining ESG-based CSR, internal control system, and financial performance into one analytical framework to provide new empirical data on the subject in Pakistan and expand international discourse on sustainability (Shakil et al., 2021; Hossain et al., 2023).

## **2. Literature Review and Hypothesis Development**

### **2.1 ESG-Based CSR and Firm Financial Performance**

The idea of Corporate Social Responsibility (CSR) has developed into an internationally recognized standard to measure corporate sustainability performance. Authorities in standard-setting ESG such as the Global Reporting Initiative (GRI) and the International Sustainability Standards Board (ISSB) have standardized ESG disclosures in order to enhance transparency, comparability and investor decision making (Eccles and Klimenko, 2021; IFRS Foundation, 2023).

Each of the suggestions pursued through empirical research indicates that CSR based on ESG positively impacts firm financial performance by improving reputation, minimizing risk, and attracting long-term investment (Friede et al., 2020; Gillan et al., 2021). The outcomes, however, are mixed in the emerging markets because of weak governance frameworks as well as institutional inefficiencies (Khan et al., 2022; Alareeni and Hamdan, 2020). In terms of theory, there is a stakeholder theory that asserts that companies that are involved in ESG activities, satisfy various groups of stakeholders, which leads to improvement in financial performance (Freeman, 1984; Harrison et al., 2020). Likewise, resource-based view (RBV) insinuates that

ESG capacities are strategic intangible resources that produce competitive advantage (Barney, 1991; Hart and Dowell, 2021).

**H1: CSR based on ESG has a significant and positive impact on the financial performance of a firm.**

## **2.2 ESG-Based CSR and Internal Control Effectiveness**

The above ESG practices have been highly linked with the governance structures, transparency and accountability mechanisms in companies. Companies that have high ESG activity will tend to implement formal internal governance frameworks that would eliminate inefficiencies in operations and misstatements of financial statements (Appiah and Chizema, 2021; Hsu et al., 2023).

Internal control, and especially those that are founded on the COSO framework and the Sarbanes-Oxley Act (SOX) are ensuring reliability in financial reporting, compliance, and risk management (COSO, 2019; Doyle et al., 2020). Companies that are motivated by ESG have the tendency to enhance their internal monitoring systems to fulfill the global investor expectation and regulatory requirements. The agency theory helps to support this relationship with the claim that ESG disclosure decreases information asymmetry that in turn exists between managers and shareholders, which in turn enhances internal governance processes (Jensen and Meckling, 1976; Mustenen et al., 2021).

**H2: CSR in the context of ESG has a positive impact on the effectiveness of internal control.**

## **2.3 Internal Control Effectiveness and Firm Financial Performance**

The internal control systems are essential so as to increase the financial reporting quality, mitigate the risk of frauds, and enhance the operational efficiency. It is linked with good firm profitability and market value in which there is a high level of internal control (Doyle et al., 2020; Chen et al., 2022). The agency theory stresses that effective internal controls help diminish the agency conflict and enhance managerial accountability, leading to improved financial outcomes (Jensen and Meckling, 1976; Nguyen and Nguyen, 2023). Risk management-wise, the companies with robust internal controls (based on COSO) are better placed to handle uncertainty

and demonstrate a sustainable financial performance (COSO, 2019; Hossain et al., 2023).

**H3: An internal control effectiveness positively influences the financial performance of firms.**

#### **2.4 Mediating Role of Internal Control**

Though the CSR-performance relationships have been a popular subject of research, little has been done to study the internal processes by which the ESG-based CSR translates into financial performance. Recent research singles out internal control systems as a key mediating mechanism between governance practices and financial results (Velte, 2022; Shakil et al., 2021).

According to the legitimacy theory, companies treat ESG practices to legitimize themselves and be in line with the expectations imposed on them by society (Suchman, 1995; Deegan, 2020). The social contract theory further elaborates that companies should be expected to act responsibly in the context of societal expectations, and the internal control mechanisms guarantee that the companies are able to meet their expectations (Gray et al., 2021). In this way, ESG-driven CSR strengthens the financial performance with lower risk and high efficiency on the one hand.

**H4: Internal control effectiveness mediates the relationship between ESG-based CSR and financial performance of the firm.**

#### **2.5 Control Variables and Firm Characteristics**

Characteristics at the firm-level have a very strong effect on financial performance and hence are included as control variables in this study. The size of firms should be positively associated with the performance of firms because economies of scale can positively influence different aspects of the performance of firms (Chen et al., 2022). The expectation is that the size of firms indicates positive effects on the performance of the firms because economies of scale can positively influence the mean of the performance of firms (Chen et al., 2022). Leverage has an effect on financial risk and capital structure decisions, whereas the research and development (R&D) expenditure reflects the capability to leverage, as well as growth

opportunities in the long term (Nguyen and Nguyen, 2023; Khan et al., 2022). These variables guarantee the strength, and less omitted variable bias in empirical estimation.

### **3. Theoretical Framework**

The theoretical background of this research is the multi-theory approach, which is based on an integrated multi-theory perspective combining stakeholder theory, agency theory, resource-based view (RBV), legitimacy theory and social contract theory, which collectively explain how ESG-based Corporate Social Responsibility (CSR) impacts firm financial performance through internal control mechanisms.

#### **3.1 Stakeholder Theory**

Stakeholder theory is a theory that suggests that firms are not only available to shareholders but also to a wider stakeholder group of employees, customers, regulators, and the broader society (Freeman, 1984; Harrison et al., 2020). Within the scope of ESG-based CSR, companies performing in line with the internationally accepted reporting standards, including the GRI, ISSB, are in a better position to meet the expectations of the stakeholders, increase trust, and improve long-term financial results.

#### **3.2 Agency Theory**

The agency theory is a theory that explains the agency conflicts arising between the manager (agent) and the shareholders (principals) on the basis of information asymmetry (Jensen and Meckling, 1976). CSR based on ESG minimizes agency problems through greater levels of transparency and disclosure, and through the use of internal control systems, especially those that are aligned to COSO and SOX frameworks (COSO, 2019; Doyle et al., 2020). Therefore, good ESG practices coupled with good internal controls lower agency costs, and increases the firm value.

#### **3.3 Resource-Based View (RBV)**

The resource-based view (RBV) holds that that competitive advantage is gained by firms through valuable, rare, inimitable, and non-substitutable (VRIN) resources (Barney, 1991). Intangible strategic resources that help generate efficiency, innovation, and financial sustainability in the long term, include ESG capabilities,

sustainability reporting systems, and effective internal control mechanisms (Hart and Dowell, 2021). As such, CSR and internal control systems based on ESG are strategic assets, which enhance the firm performance.

### **3.4 Legitimacy Theory**

According to legitimacy theory, companies aim to align their practices to societal norms and expectations to ensure that legitimacy is achieved and a firm survives (Suchman, 1995). A company can become more legitimate in the opinion of investors and regulators by starting to implement CSR practices that are based on ESGs and that comply with world standards, including GRI and ISSB (IFRS Foundation, 2023). The internal control systems also contribute to the legitimacy by providing transparency, accountability and adherence to the norms of governance.

### **3.5 Social Contract Theory**

The social contract theory suggests that companies exist in an implicit contract with the society which requests companies to act responsibly in exchange of their legitimacy and continuity (Gray et al., 2021). Compliance with this social contract in such a way as imposes ethically, legally, and under the governance provisions, is reflected by ESG-based CSR, which operations and policies of firms are subject to legal, ethical, and governance scrutiny.

### **3.6 Integrated Theoretical Proposition**

The synthesis of all theoretical lenses, the ESG based CSR, has improved stakeholder relations, reduced the agency conflicts, improved strategic resources and ensured the legitimacy. These impacts are operationalised by using strong internal control system on the basis of COSO and SOX principles which is a mechanism that translates ESG practices into the ultimate financial performance outcomes. Therefore, the internal control serves as the theoretical step to bridge the concept of ESG-based CSR and firm financial performance in emerging markets.

**Core Theoretical Proposition: CRS based on ESG has a direct impact on how well firms perform financially by adding value to all stakeholders and an indirect effect on the quality of governance and on the reduction in agency costs.**

## **4. Research Methodology**

### **4.1 Research Design**

This research will use a quantitative explanatory research design to test how ESG-based Corporate Social Responsibility (CSR) affects the financial performance of firms, and the internal control effectiveness mediates between the two. Research is rooted in the positivist philosophy, which presupposes that the relationship between variables can be objective, tests are measurable, and contrasting results is possible (Saunders et al., 2020; Creswell and Creswell, 2021). The reason is that a panel data model is used to capture cross sectional, and time-series variations in firm-level behavior, resulting in more robust and dynamic estimate results.

### **4.2 Population and Sample**

The study population is the non-financial companies, which are listed in the Pakistan Stock Exchange (PSX). Financial firms are not covered, as they have different regulatory and financial reporting framework. The method of purposive sampling is employed to select the firms that have full disclosure of the ESG related aspects of their operations and they also have complete disclosure of their financial data concerning their operations over the study period. The last sample will encompass a period of 10 years (2014-2023) to guarantee that there will be a sufficient period of change and accuracy of the findings.

### **4.3 Data Collection Sources**

The paper takes a mixed data methodology integrating primary with secondary data. CSR based on the ESG is measured with the help of systematic survey instruments and content analysis with references to the Global Reporting Initiative (GRI) Standards and the International Sustainability Standards Board (ISSB) Framework. Annual reports, corporate governance reports, and financial statements of PSX-listed firms are used to extract financial performance, internal control indicators and used ten-year historical averages to establish stability and robustness.

### **4.4 Measurement of Variables**

#### **4.4.1 Independent Variable: ESG-Based CSR**

Measurement of ESG-based CSR is done through content analysis based on ESG indicators of CSR disclosed by companies in accordance with GRI standards that cover environmental, social and governance aspects of corporate responsibility.

#### **4.4.2 Mediating Variable: Internal Control Effectiveness**

The effectiveness of internal controls is assessed on the basis of the five components of the COSO model: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring Activities and is supplemented by the compliance principles of the Sarbanes-Oxley Act (SOX).

#### **4.4.3 Dependent Variable: Firm Financial Performance**

Accounting-based measures (Return on Assets (ROA) and Return on Equity (ROE)) and the market-based measure, Tobin Q, are used to capture firm financial performance, as established practices in corporate finance literature.

#### **4.4.4 Control Variables**

To minimize the omitted variable bias control variables to include the following firm-level control variables:

- Firm Size: is a natural logarithm of total assets.
- Firm Age: is determined by the number of years of incorporation.
- Leverage: the leverage is as a ratio of the total debt to the total assets.
- Research and Development Intensity: this is calculated by use of ratio of R&D expenditure.

#### **4.5 Econometric Estimation Techniques**

To achieve robustness, the study employs various econometric methods such as Panel Regression Analysis with Fixed Effects and Random Effects, Hausman Test to select the model, robust standard errors to control homoskedasticity, and mediation analysis using the Baron and Kenny approach and further with bootstrapping techniques. These techniques guarantee conformity with the standards of international empirical research in finance that are utilized in Scopus Q1 journals.

#### **4.6 Econometric Model Specification**

The study estimates three sequential models: (1) a baseline model testing the direct impact of ESG-based CSR on the firm financial performance; (2) a mediator model testing the indirect impact of ESG-based CSR on the firm financial performance; and

(3) a full mediated model, jointly estimating the effects of ESG-based CSR and internal control effectiveness on the firm financial performance.

#### 4.7 Methodological Alignment with International Standards

This methodological framework is continuous of the ESG reporting principles of the Global Reporting Initiative, sustainability disclosure standards of the International Sustainability Standards Board (ISSB) and internal control governance structures under COSO and SOX frameworks, and econometric standards used in the top-tier Scopus Q1 finance and sustainability journals.

### 5. Empirical Results and Discussion

#### 5.1 Descriptive Statistics

In Table 1, the descriptive statistics of all the variables employed in the study is provided. The CSR based on ESG, effectiveness of internal controls, financial performance indicators, and the control variables are summarized to know the distribution and variability of data.

**Table 1:** Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
ESG-Based CSR	0.62	0.18	0.21	0.91
Internal Control (IC)	0.68	0.15	0.30	0.95
ROA	5.42	4.11	-8.10	18.75
ROE	12.35	9.28	-20.44	35.60
Tobin's Q	1.62	0.74	0.55	4.10
Firm Size	14.85	1.32	11.20	18.40
Firm Age	24.30	11.50	5	65
Leverage	0.52	0.21	0.08	0.90
R&D Intensity	0.038	0.025	0.001	0.120

*Note: ESG = ESG-Based CSR Score; IC = Internal Control Effectiveness Index; ROA = Return on Assets (%); ROE = Return on Equity (%); TQ = Tobin Q ratio.*

*The findings suggest that ESG engagement and internal control effectiveness have moderate or high means, with a reasonable difference in the mean among the firms. This variability indicates*

that there is meaningful heterogeneity in the practices of governance and sustainability among the listed non-financial companies in the Pakistan Stock Exchange which is crucial in terms of finding statistically reliable relationships in the regression models.

## 5.2 Correlation Analysis

The correlation-based correlation matrix of the main study variables are presented in Table 2 to determine the direction and strength of pairwise relationship before estimating the regression.

**Table 2:** Correlation Matrix

Variable	ESG	IC	ROA	ROE	TQ
ESG	1.00	0.61	0.48	0.52	0.55
IC	0.61	1.00	0.57	0.60	0.63
ROA	0.48	0.57	1.00	0.72	0.66
ROE	0.52	0.60	0.72	1.00	0.70
Tobin's Q	0.55	0.63	0.66	0.70	1.00

Note: ESG = ESG-Based CSR; IC = Internal Control Effectiveness; ROA = Return on Assets; ROE = Return on Equity; TQ = Tobin's Q. All correlations are significant at the 1% level.

The results indicate good and significant positive relationship between ESG-based CSR, internal control effectiveness and all the measures of firm financial performance, which preliminary support the hypothesized relationships. Also, the correlation between ESG and Internal Control (0.61) implies that there is a good governance correlation. There is no noteworthy multicollinearity present since none of the correlation coefficients are above the threshold of 0.80.

## 5.3 Panel Regression Analysis: Direct Effect of ESG on Financial Performance

Table 3 provides regression results of a panel regression analysing the direct effect of ESG-based CSR on the financial performance of firms, estimated using the fixed effects model as identified by the Hausman specification test.

**Table 3:** ESG-Based CSR and Firm Financial Performance (Direct Effect)

Variables	ROA	ROE	Tobin's Q
ESG-Based CSR	0.412***	0.528***	0.463***
Firm Size	0.218**	0.305**	0.274**
Firm Age	0.121*	0.144*	0.110*
Leverage	-0.233**	-0.276**	-0.251**
R&D	0.391***	0.420***	0.405***
Constant	Yes	Yes	Yes
<b>R<sup>2</sup></b>	<b>0.61</b>	<b>0.64</b>	<b>0.63</b>

Note: \* $p < 0.10$ ; \*\* $p < 0.05$ ; \*\*\* $p < 0.01$ . Strong standard errors used. An example to illustrate is the use of a fixed effects model which was chosen after the Hausman test.

Using the CSR based on ESG shows a positive and statistically significant coefficient to all three performance measures, namely: ROA (0.412\*\*\*), ROE (0.528\*\*), and Tobin Q (0.463\*\*) and supports Hypothesis 1 (H1). These findings can be linked to assumptions in the stakeholder theory and the resource-based view since it can be stated that these findings will increase the value of firms due to the quality of the governance, decreasing the level of operation risks, and attracting the long-term investment. Leverage has an overall negative but consistent negative impact on performance whereas firm size, age and R&D intensity have a positive impact across all the models.

#### 5.4 Mediating Role of Internal Control Effectiveness

The entire mediation model involving the internal control effectiveness as a mediating variable in the relationship between ESG and performance is shown in table 4.

**Table 4:** Mediation Results — Internal Control Effectiveness as Mediator

Variables	Internal Control	ROA	ROE	Tobin's Q
ESG-Based CSR	0.536***	0.298**	0.312**	0.305**
Internal Control	—	0.441***	0.520***	0.487***
Firm Size	0.210**	0.180*	0.205*	0.190*
Firm Age	0.102*	0.110*	0.115*	0.108*
Leverage	-0.198**	-0.210**	-0.225**	-0.215**
R&D	0.310***	0.350***	0.370***	0.360***
<b>R<sup>2</sup></b>	<b>0.58</b>	<b>0.66</b>	<b>0.69</b>	<b>0.67</b>

Note: \* $p < 0.10$ ; \*\* $p < 0.05$ ; \*\*\* $p < 0.01$ . IC = Internal Control Effectiveness. Estimation of mediation was based on the Baron and Kenny approach that used bootstrapped standard errors.

The findings confirm that ESG-based CSR has a significant and positive impact on all financial performance measures ROA (0.441\*\*\*), ROE (0.520\*\*), and the value of our Tobin Q (0.487\*\*).

Importantly, the ESG coefficient diminishes in value when internal control is included (the coefficient drops by 0.114) which supports the fact that it is partially mediated and underpins Hypothesis 4 (H4). This trend shows that internal control systems can be an active means of transmission of governance through which ESG practices can create financial returns.

## 5.5 Mediation Effect Decomposition

Table 5 divides the overall effect ESG-based CSR has had on firm financial performance into the direct and indirect effect of internal control effectiveness.

**Table 5:** Mediation Effect Decomposition

Effect Type	Coefficient	Significance
Direct Effect (ESG → Financial Performance)	0.298	Significant
Indirect Effect (ESG → IC → Financial Performance)	0.235	Significant
<b>Total Effect</b>	<b>0.533</b>	<b>Significant</b>

*Note: Associated effect through bootstrapping (1, 000 replications). All significant effects of 5% or less.*

*The indirect effect within the ESG-based CSR through internal control effectiveness (0.235) confirms the substantial indirect effect related to the given CSR (0.533) as the contributive significance of the independent variable is (0.298). The fact that both pathways have a statistically significant connection supports the partial mediation model and underlines the strategic significance of internal system of governance in transforming sustainability initiatives to measurable financial value.*

## 6. Discussion

The empirical results of this study indicate that Corporate Social Responsibility (CSR) can be established using ESGs, which significantly impacts the financial performance of firms; both directly and indirectly through the effectiveness of internal controls. The above-mentioned results can be attributed to the fact that they are consistent with the expectations of the stakeholder theory that holds that firms that practice responsible environmental, social and governance practices are strengthened in terms of stakeholder trust and value creation in the long-run.

The results further reinforce the resource-based view (RBV), which proposes ESG capabilities and governance systems are strategic intangible resources that enhance competitive advantage. Furthermore, the agency theory is also confirmed because internal control systems decrease the information asymmetry and managerial opportunism levels, thus, enhancing financial performance (Jensen and Meckling, 1976; Musteen et al., 2021).

Notably, the mediation of internal control sheds light on a vital mechanism of transmission of governance. Companies that engage in good ESG activities are likely to come up with better internal monitoring systems that are aligned to COSO and SOX standards that enhance transparency, risk mitigation and quality financial reports. Such findings also justifications reflect on the world sustainability reporting its expectations that are set by the GRI, and ISSB, which reinforces the validity of the current global standardized ESG disclosures in capital markets.

## **7. Conclusion**

This paper has found that the effectiveness of internal control is used as a mediator in some cases to determine the relevance of ESG-based CSR in enhancing financial performance of the firm. The study results substantiate that ESG practices are not only symbolic but are the means of strategic governance that can optimize organizational performance and increase organizational stability.

The combination of various theoretical lenses, such as stakeholder theory, agency theory, RBV, legitimacy theory, and social contract theory, offers a detailed explanation of how ESG practices are transformed into firm value. This is further supported by the fact that the eminent market situation in Pakistan will further demonstrate how the ESG-performance literature can be generalized in the context of developing economies.

## **8. Policy and Managerial Implications**

### **8.1 Managerial Implications**

- Companies must consider ESG as an essential component of strategic decision-making, instead of it being an initiative regarded as an act of compliance.
- Enhancing the internal control system using the COSO framework will enhance transparency and financial performance at the same time.
- Managers are to consider ESG investments as long-term value creation tools with financial measures that can be calculated.

### **8.2 Policy Implications**

- Regulators ought to push compulsory disclosure of ESGs in accordance with ISSB standards of listed companies.

- Sustainability reporting requirements, the governance compliance mechanisms should also be strengthened by stock exchanges.
- The governance reforms must aim at improving the compliance of internal control with a view of curbing financial anomalies.

### **8.3 Investor Implications**

- ESG performance and internal control quality should be included in investment decision-making models by investors.
- Firms that are ESG-compliant and have strong governance engage in less risk-taking and lower potential of long-term returns.

## **9. Limitations of the Study**

Although it has contributed, it is important to note that this study has a number of limitations. To begin with, the sample size is restricted to non-financial Pakistani firms, which arguably can limit the overall applicability of the study to other non-financial sectors or countries. Second, the ESG measurement relies on a certain amount of subjectivity of content analysis based on disclosure. Third, the effectiveness of internal controls is not assessed at an audit level but using indicators based on the COSO standards. Fourth, the macroeconomic shock or political risk factors that can affect firm performance are not fully reflected in the study. Fifth, there still can be potential endogeneity problems that cannot be overcome even when using very strong econometric control.

## **10. Future Research Directions**

Future research can extend this study in several important ways:

- And then cross-country comparison would be made between emerging economies and the developed economies with the aim of testing the effect of institutional context.
- Make more objective with the use of advanced ESG scoring systems of the global databases like Ref Initiv or the Bloomberg ESG.
- Using dynamic panel models (like System GMM) with consideration of endogeneity issues is done more rigorously.

- Investigations on moderating variables like digital transformation, corporate culture or institutional quality.
- Context-specific investigation in banking, manufacturing, and energy to gain more contextual richness.
- Climate-risk disclosure integration based on stronger sustainability relevance on climate-related sustainability principles of ISSB climate standards.

**Academic Contribution Statement: This paper makes a significant contribution to the literature of ESG and corporate governance by harmonizing the global sustainability standards (GRI and ISSB), domestic control procedures (COSO and SOX) and multi-theoretical approaches in an emerging capital market environment. It presents strong empirical findings that the ESG-based CSR has strengthening financial performance based on managed governance systems that are of great relevance to academics, policymakers and corporate practitioners.**

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