

# Analysis of Firm Value Influenced by Environmental, Social, Governance with Financial Performance as an Intervening Variable

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## ABSTRACT

*Firm value has shifted from a shareholder-centered view to a broader stakeholder perspective. Investors consider ESG factors alongside financial performance, which remains essential in reflecting a company's profitability and debt management capacity. This study aims to analyze the effect of environmental, social, and governance on firm value mediated by financial performance. This quantitative study examined companies listed on the Indonesia Stock Exchange (IDX) during 2022–2024. The sample was determined using purposive sampling based on specific criteria. Data were analyzed using Partial Least Squares Structural Equation Modeling (PLS-SEM) with SmartPLS software. The results of the study indicate that environmental, social, and governance have a significant influence on financial performance. ESG has a significant impact on firm value, indicating that companies with higher levels of ESG coverage tend to have higher firm value. Financial performance significantly influences firm value, indicating that the market values companies that demonstrate stable financial performance. Financial performance partially mediates the relationship between environmental, social, and governance and firm value. These findings imply that companies should integrate ESG practices into their strategic and financial policies to enhance performance and increase firm value in the long term.*

**Keywords:** *ESG, Financial Performance, Firm Value, Indonesia Stock Exchange, Stakeholder Theory.*

## INTRODUCTION

Rapid economic development has intensified competition across industries, compelling companies not only to generate profits but also to enhance and sustain firm value. Traditionally, firm value was primarily associated with shareholder wealth, as shareholders were viewed as the dominant stakeholders within the firm. However, this perspective has gradually evolved into a broader stakeholder-oriented approach, recognizing that long-term corporate success depends on the ability to address the interests of multiple stakeholder groups (Nurhidayanti et al., 2023). Alongside this shift, investor perceptions have also changed. ESG considerations are increasingly integrated into investment decision-making processes. Delevingne et al. (2020) report that more than 83% of executives and investors believe ESG contributes to long-term firm value, highlighting the growing importance of sustainability factors in corporate valuation.

In Indonesia, awareness of sustainability disclosure has strengthened significantly. According to a 2020 survey by the Global Reporting Initiative (GRI), Indonesia ranked highest among 27 countries in sustainability reporting disclosure, with public trust reaching 81%, an increase of two percentage points compared to 2016. This finding indicates that transparency in ESG reporting is increasingly valued by stakeholders. In

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line with signaling theory, ESG disclosure functions as a positive signal to investors, demonstrating that a company is committed not only to maximizing shareholder wealth but also to fulfilling broader social and environmental responsibilities (Zahroh & Hersugondo, 2021). Such disclosure reduces information asymmetry and enhances investor confidence, ultimately contributing to higher firm value. The relevance of ESG is particularly evident in the energy sector, which plays a crucial economic role while also generating substantial environmental impact. Ritchie (2020) notes that the energy sector accounts for approximately 73% of global greenhouse gas emissions, underscoring the urgency of sustainable transformation within this industry.

ESG is widely recognized as a non-financial performance indicator encompassing environmental, social, and governance dimensions (Roestanto et al., 2022). A growing body of empirical research has examined the relationship between ESG disclosure and firm value, yet findings remain inconsistent. Earlier studies, such as Yip and Lee (2018), Aboud and Diab (2018), Atan et al. (2018), and Rahayu et al. (2025), report mixed results, ranging from positive to insignificant or even negative effects. More recent studies, including Qureshi et al. (2020), Melinda and Wardhani (2020), Ahmad et al. (2022), and Roestanto et al. (2022), further confirm the variability of results across contexts and measurement approaches. These inconsistencies suggest that the ESG firm value relationship may not be purely direct.

To address these divergent findings, this study incorporates financial performance as an intervening variable. Financial performance, commonly proxied by Return on Equity (ROE), Debt-to-Equity Ratio (DER), and Earnings per Share (EPS), reflects a company's ability to generate profits, manage capital structure, and maintain financial stability (Olimsar et al., 2023). Prior research by Ahmad et al. (2022) demonstrates that financial performance positively influences firm value, although other studies, such as Atarwaman (2025), report insignificant effects. Furthermore, ESG practices have been shown to enhance future financial performance and corporate growth by attracting investors, reducing risk, and lowering the cost of capital (Yoon et al., 2018; Duque-Grisales & Aguilera-Caracuel, 2021; Aydoğmuş et al., 2022; Wu et al., 2022). Therefore, examining financial performance as a mediating mechanism is essential to better understand how ESG activities translate into higher firm value. Based on this background, this study aims to analyze the effect of environmental, social, and governance on firm value mediated by financial performance.

## **LITERATURE REVIEW & HYPOTHESIS DEVELOPMENT**

### **The Effect of ESG on Financial Performance**

Environmental, Social, and Governance (ESG) has gained substantial attention as an important factor influencing corporate performance. In their comprehensive meta-analysis of more than 2,000 empirical studies, Friede et al. (2015) reported that nearly 90% of the reviewed studies identified a positive association between ESG practices and corporate financial performance. These findings indicate that effective ESG implementation may serve as a strategic driver for achieving sustainable competitive advantage and long-term firm value.

From a theoretical perspective, Stakeholder Theory explains that firms addressing the interests of employees, customers, communities, and the environment are more likely to achieve superior long-term performance (Bashatweh et al., 2021; Ahmad et al., 2021; Fuadah et al., 2022). This view is strengthened by the Resource-Based View (RBV), which argues that ESG engagement builds valuable and hard-to-imitate intangible assets such as reputation, customer loyalty, and social capital that enhance competitive advantage and financial performance (Zheng et al., 2025).

Empirical studies across various institutional settings consistently support this perspective. Habib and Mourad (2023) found that firms with higher ESG performance tend to achieve stronger financial results, while Chen et al. (2023) demonstrated that environmental performance improves firm outcomes through green innovation mechanisms. In the context of emerging markets, Biju et al. (2025) documented a

significant positive relationship between ESG scores and indicators of profitability (ROA, ROE) as well as market-based measures such as Tobin's Q. Additionally, Xie et al. (2019) highlighted that ESG practices help reduce agency costs and increase transparency, whereas Narula et al. (2025) concluded that both theoretical and empirical evidence predominantly confirm a positive linkage between ESG and corporate performance.

H1: ESG has a positive effect on financial performance.

### **The Effect of ESG on Firm Value**

Firm value represents how the market evaluates a company's future growth potential and long-term sustainability. Within the ESG framework, Signaling Theory suggests that companies that voluntarily disclose ESG information convey favorable signals to investors regarding their commitment to sustainable value creation and prudent risk management (Li et al., 2025). This increased transparency helps reduce information asymmetry, build investor trust, and ultimately improve market valuation. Numerous empirical studies document a positive link between ESG performance and firm value, commonly measured by Tobin's Q and Price-to-Book Ratio (PBR). Zhao et al. (2022) found a significant and robust positive association between aggregate ESG performance and firm value among Chinese firms. Likewise, Abdi et al. (2022) reported that ESG scores improve firm value and profitability in the global airline industry, while Li et al. (2025) showed that stronger ESG disclosure among FTSE-listed companies enhances firm value through greater stakeholder trust and accountability.

Cross-country evidence further reinforces this relationship. Agnieszka et al. (2024) and Li et al. (2025) demonstrated that ESG performance contributes positively to firm value across different regions, with corporate transparency and emerging market characteristics amplifying the effect. Zhou and Luo (2022) additionally highlighted that financial performance serves as a mediating factor in the ESG-firm value linkage. Evidence from emerging economies, including Indonesia, supports these findings. Akbar et al. (2022) showed that profitability and liquidity significantly increase firm value among companies included in the IDX ESG Quality 45 index, while Chairani and Siregar (2021) confirmed that higher ESG scores are positively associated with Tobin's Q.

H2: ESG has a positive effect on firm value.

### **The Effect of Financial Performance on Firm Value**

The linkage between financial performance and firm value represents a core issue in corporate finance. Financial performance, typically measured using Return on Assets (ROA) and Return on Equity (ROE), indicates how efficiently management utilizes company resources to generate earnings. In contrast, firm value, often proxied by Tobin's Q, reflects the market's evaluation of a firm's capability to create value exceeding the replacement cost of its assets (Saygili et al., 2022). Based on Signaling Theory, strong profitability sends a favorable signal to investors regarding managerial effectiveness and future growth prospects, which subsequently enhances firm valuation (Atiningsih & Izzaty, 2021).

Empirical studies provide consistent support for this relationship. Bui et al. (2023), Fatima et al. (2023), and Hardianti et al. (2023) demonstrate that profitability, particularly ROA, exerts a positive and significant influence on firm value. Evidence from infrastructure firms listed on the Indonesia Stock Exchange (IDX) during 2019–2023 similarly indicates that higher profitability leads to increased Tobin's Q. Sari and Widiatmoko (2023) also highlight the important role of financial performance in shaping firm value in Indonesia, although external factors such as investor sentiment and industry outlook remain influential. Additional findings from Naeem et al. (2022) confirm that ROA positively impacts Tobin's Q in both developed and emerging markets. Zheng et al. (2025) further argue that ESG practices that improve financial performance ultimately strengthen market valuation. Supporting this view, Rahman et al. (2023) report that ROA

has a significant coefficient of 0.338 in explaining firm value among ASX-listed companies, indicating that greater asset efficiency results in stronger market appreciation.

H3: Financial performance has a positive effect on firm value.

### Financial Performance as a Mediating Variable

The mediating function of corporate performance in the ESG–firm value relationship has attracted growing scholarly interest, especially within developing economies. From a theoretical perspective, Stakeholder Theory suggests that effective ESG implementation fosters stakeholder trust and long-term commitment, which in turn improves operational performance and profitability. These financial improvements are subsequently reflected in the capital market through enhanced firm valuation (Zhou et al., 2022). Empirical research increasingly validates this mechanism. Rezky et al. (2024) demonstrate that financial performance, proxied by ROA, fully mediates the relationship between ESG and firm value in Indonesian commercial banks during 2019–2023, implying that ESG affects firm value indirectly through profitability.

Srivastava and Anand (2023) similarly report a significant mediating role of ROA in linking ESG disclosure to firm value. Consistent findings are provided by Zhou and Luo (2022) for Chinese listed firms and by Ramadhani et al. (2024), who show that ROA mediates the influence of ESG disclosure on Tobin’s Q among IDX ESG Leaders (2022–2024). Additionally, Putri and Meilanda (2025) find that financial performance-driven competitive advantage strengthens the positive association between ESG and firm value across Asian markets. This mediation operates through multiple pathways. ESG initiatives may lower operational risk and reduce the cost of capital, thereby improving profitability, which subsequently serves as a positive signal to investors. Although Nareswari et al. (2023) suggest that the strength of this mediating effect can vary depending on market conditions, the prevailing empirical evidence largely supports financial performance as a significant intermediary in the ESG firm value nexus.

H4: Financial performance mediates the relationship between ESG and firm value.

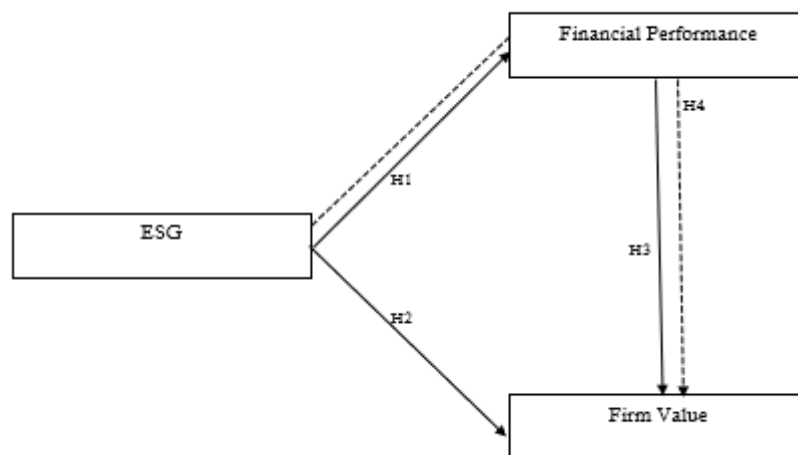


Figure 1. Conceptual Framework

Figure 1 presents the research model examining the effect of ESG performance on firm value, with financial performance acting as a mediating variable. ESG is hypothesized to exert a direct influence on both financial performance and firm value, while financial performance is also expected to affect firm value directly. Hypothesis H4 specifically tests the mediating role of financial performance, proposing that ESG enhances firm value indirectly through improvements in financial performance.

## RESEARCH METHODS

This study employed a quantitative research design with an explanatory approach to examine the relationships among Environmental, Social, and Governance (ESG), financial performance, and firm value. The population consisted of all companies listed on the Indonesia Stock Exchange (IDX) during the 2022–2024 period. The sample was determined using purposive sampling based on specific criteria, including the availability of complete annual reports, sustainability reports, ESG data, and financial statements for the observation period. The study utilized secondary data obtained from publicly available corporate reports and official capital market sources.

Firm value in this study is proxied by stock market value, Price-to-Book Value (PBV), and Tobin's Q. Market value represents the price agreed upon by buyers and sellers in stock market transactions and is commonly viewed as a reflection of the firm's actual asset valuation. PBV is widely applied in investment analysis because it compares market valuation to book value, making it useful for assessing investment attractiveness. Tobin's Q, meanwhile, captures the market's assessment of a firm's ability to generate returns from additional investments, thereby reflecting growth prospects and value creation potential.

ESG performance is measured using the ESG Disclosure Score provided by Bloomberg, which ranges from 0 to 100. This scoring system is developed based on the Global Reporting Initiative (GRI) and Investor Stewardship Group (ISG) frameworks. The ESG score comprises three equally weighted dimensions: environmental, social, and governance, each contributing 33%. The environmental dimension evaluates factors such as air quality, climate change, biodiversity, ecological impact, energy use, materials and waste management, supply chain practices, and water management. The social dimension covers community and customer relations, diversity, ethics and compliance, occupational health and safety, human resources, and supply chain responsibility. The governance dimension includes audit risk oversight, board composition, diversity and independence, nomination practices, sustainability governance, and board tenure.

Financial performance is proxied by Return on Assets (ROA), Return on Equity (ROE), and leverage. ROA reflects managerial efficiency in utilizing company assets to generate profits. ROE indicates the firm's ability to generate returns for shareholders and is often considered an important signal for investors. Leverage is included to capture the extent of debt utilization, as higher leverage may be associated with greater expected returns, albeit accompanied by higher financial risk.

Data analysis in this research employs Structural Equation Modeling (SEM) using the Partial Least Squares (PLS) approach through SmartPLS software. In reflective measurement models, PLS analysis involves evaluating both the outer (measurement) model and the inner (structural) model. The outer model is assessed through tests of convergent and discriminant validity, where cross-loading results help confirm convergent validity. Reliability is examined using Cronbach's alpha. After establishing the validity and reliability of the measurement model, the inner model is evaluated to test the structural relationships among variables.

## RESULTS

This research examines the effect of Environmental, Social, and Governance (ESG) disclosure on firm value, with financial performance acting as a mediating variable, in energy-sector companies in Indonesia. The study population consists of all energy-sector firms listed on the Indonesia Stock Exchange (IDX) during the 2022–2024 period. A purposive sampling technique was applied, using specific selection criteria: companies that consistently issued both annual and sustainability reports in line with the Global Reporting Initiative (GRI) standards over the three-year observation period. Based on these criteria, the final sample comprised 63 annual financial and sustainability reports collected from 2022 to 2024.

According to Ghozali and Latan (2019), the association between item/indicator scores and concept scores demonstrates the convergent validity of the measuring model with reflecting indicators. The loading factor (outer loading) is the name given to this association. The outer loading value can be seen in Table 1.

**Table 1.** Convergent Validity (Outer Loading)

Indicator Variables	Outer Loading
Environmental (ESG)	0.745
Social (ESG)	0.893
Governance (ESG)	0.784
ROA (FP)	0.752
ROE (FP)	0.867
Leverage (FP)	0.807
Stock Market Value (FV)	0.882
Price Book Value (FV)	0.740
Tobin's Q (FV)	0.832

The results presented in Table 1 indicate that all indicators used in the study meet the requirements of convergent validity. This is demonstrated by the outer loading values of each indicator, which are above the recommended threshold of 0.70, indicating that each indicator has a strong correlation with its respective construct. In the ESG construct, the social dimension shows the highest loading (0.893), followed by governance (0.784) and environmental (0.745), suggesting that social aspects contribute most strongly to measuring ESG performance. For the financial performance construct, ROE has the strongest loading (0.867), followed by leverage (0.807) and ROA (0.752), indicating that profitability and capital structure effectively represent financial performance. Meanwhile, in the firm value construct, stock market value demonstrates the highest loading (0.882), followed by Tobin's Q (0.832) and price book value (0.740). These results confirm that all indicators are valid and adequately reflect their respective latent variables, allowing the measurement model to be considered reliable for further analysis.

**Table 2.** AVE and CR

Variables	Cronbach's Alpha	CR (rho_a)	CR (rho_c)	AVE
ESG	0.926	0.933	0.943	0.733
Financial Performance (FP)	0.916	0.922	0.932	0.633
Firm Value (FV)	0.887	0.907	0.913	0.605

The results in Table 2 indicate that all constructs demonstrate good reliability and convergent validity. This is shown by the Cronbach's Alpha values for ESG (0.926), FP (0.916), and FV (0.887), all of which exceed the recommended threshold of 0.70, sreliability values (rho\_a and rho\_c) for all variables are above 0.70, confirming that each construct has high measurement reliability. Furthermore, the Average Variance Extracted (AVE) values for ESG (0.733), FP (0.633), and FV (0.605) exceed the minimum criterion of 0.50, indicating that each construct explains more than half of its indicators' variance. Thus, these findings confirm that the measurement model satisfies reliability and convergent validity requirements and is suitable for further structural model analysis.

The indicators of each latent variable in this study are genuine and dependable in reflecting their respective variables, according to the loading factor values, Average Variance Extracted, and Composite Reliability (CR). By looking at the R-squared value as the goodness-of-fit statistic, the structural model (inner model) is tested.

**Table 3.** R Square dan R Square Adjusted

Variable	R-Square	R-Square Adjusted
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Financial Performance	0.640	0.638
Firm Value	0.665	0.661

The results in Table 3 show that the model has a strong explanatory power in predicting the endogenous variables. The R-square value for financial performance is 0.640, indicating that 64.0% of the variance in financial performance can be explained by the independent variables included in the model, while the remaining 36.0% is influenced by other factors outside the model. Similarly, the R-square value for firm value is 0.665, meaning that 66.5% of the variation in firm value is explained by the model, with 33.5% explained by other variables not examined in this study. The R-square adjusted values, which are slightly lower (0.638 for financial performance and 0.661 for firm value), indicate that the model remains stable after adjusting for the number of predictors. These results suggest that the structural model has substantial predictive capability and provides a good explanation of both financial performance and firm value.

**Table 4.** Total Effects

Path	Original Sample	Sample Mean	Standard Deviation	t-statistics	p-values
ESG → Financial Performance	0.461	0.474	0.123	3.756	0.000
ESG → Firm Value	0.690	0.684	0.107	6.470	0.000
Financial Performance → Firm Value	0.446	0.435	0.111	4.010	0.000

The results presented in Table 4 indicate that all hypothesized relationships show positive and statistically significant total effects. The relationship between ESG and financial performance shows a positive effect with a coefficient of 0.461 and a t-statistic of 3.756 ( $p < 0.001$ ), indicating that better ESG performance significantly improves financial performance. Furthermore, ESG has a stronger positive effect on firm value, with a coefficient of 0.690 and a t-statistic of 6.470 ( $p < 0.001$ ), suggesting that ESG practices play an important role in enhancing market valuation. In addition, financial performance also has a significant positive effect on firm value, with a coefficient of 0.446 and a t-statistic of 4.010 ( $p < 0.001$ ), meaning that improved financial performance contributes to higher firm value. These findings confirm that ESG not only directly influences firm value but also indirectly strengthens it through financial performance, indicating the important role of sustainability practices in improving corporate outcomes.

**Table 5.** Specific Indirect Effects

Test	Result
Path	ESG → Financial Performance → FV
Original Sample	0.312
Sample Mean	0.326
Standard Deviation	0.107
t-statistics	2.967
p-values	0.003

The results in Table 5 show that ESG has a positive and significant indirect effect on firm value through financial performance. This is indicated by the indirect effect coefficient of 0.312 with a t-statistic of 2.967 and a p-value of 0.003 ( $p < 0.05$ ). These findings suggest that financial performance acts as a mediating variable in the relationship between ESG and firm value. In other words, improved ESG performance enhances financial performance, which in turn contributes to increasing firm value. Therefore, the mediation effect confirms that the influence of ESG on firm value occurs not only directly but also indirectly through improved financial performance.

## DISCUSSION

The findings suggest that ESG implementation in Indonesian energy-sector firms remains in a transitional stage. The environmental dimension has not yet improved financial performance, likely due to high short-term costs related to compliance, emission

reduction, and sustainability investments that outweigh immediate benefits in this capital-intensive and highly regulated industry. In contrast, the social dimension positively contributes to financial performance, as disclosures on labor practices, workplace safety, and community development strengthen stakeholder support, productivity, and operational stability. This result aligns with Safriani and Utomo (2020), who found that ESG disclosure positively affects financial performance, particularly through the social dimension. Similarly, Aydoğmuş et al. (2022) reported that ESG performance improves firm value and profitability, especially in firms with strong governance mechanisms.

However, the influence of ESG on financial performance in Indonesia appears weaker compared to evidence from more developed markets. One key explanation lies in disclosure quality. Many firms still provide ESG information in a symbolic or compliance-oriented manner, limiting its credibility in the eyes of investors. This finding supports Angir and Weli (2024), who emphasize that the effectiveness of ESG in improving financial outcomes depends heavily on the quality and substance of disclosure.

The study finds a significant positive relationship between ESG and firm value, proxied by Tobin's Q and PBV, indicating that higher ESG disclosure is associated with stronger market valuation. This supports Friede et al. (2015), who report predominantly positive ESG–value linkages, and Fatemi et al. (2018), who show that strong environmental performance reduces regulatory and litigation risks, particularly in sensitive sectors like energy. In Indonesia, the results are consistent with Sari and Widiatmoko (2023), highlighting the importance of ESG social disclosure supported by good governance. However, the relationship remains heterogeneous, with investor trust and disclosure credibility acting as key moderating factors.

Financial performance emerges as a strong determinant of firm value. Profitability indicators (ROA/ROE) and leverage significantly influence Tobin's Q and PBV, confirming that the market rewards firms with stable earnings and solid financial fundamentals. This finding is consistent with prior studies in the energy sector showing that profitability is a key driver of valuation, particularly in industries dependent on cash flow stability and long-term capital investment. Broadstock et al. (2021) similarly found that energy companies with stronger financial fundamentals experienced smaller valuation declines during crises. The cyclical nature of energy markets further strengthens the importance of profitability as a signal, as investors rely on historical financial resilience to assess future performance.

The mediation results show that financial performance is the main channel through which ESG influences firm value. When ROA is included, the direct effect of ESG becomes insignificant while ROA remains significant, indicating partial to full mediation. This implies that ESG enhances firm value primarily by improving economic fundamentals rather than through reputational effects alone. The findings support stakeholder theory and signaling theory, emphasizing that financial performance is a more credible signal to investors than ESG disclosure itself. Empirically, the results are consistent with Friede et al. (2015), Khan et al. (2016), Broadstock et al. (2021), and Sari and Widiatmoko (2023), all of whom highlight the mediating role of financial performance in strengthening the ESG–firm value relationship.

These findings imply that ESG strategies in the Indonesian energy sector must move beyond symbolic disclosure toward substantive implementation that enhances profitability and operational efficiency. Policymakers should strengthen ESG reporting standards to improve disclosure credibility, while corporate managers should align sustainability initiatives with financial objectives to ensure value creation. For investors, financial performance remains the primary mechanism through which ESG is translated into firm value, suggesting that ESG analysis should be integrated with fundamental financial assessment when evaluating energy-sector companies.

## **CONCLUSION**

The findings of this study demonstrate that ESG factors have a statistically significant effect on financial performance and that ESG also exerts a significant positive influence on firm value. This suggests that firms with more robust ESG practices tend to be valued

more highly by the market, as stakeholders increasingly consider sustainability criteria in investment decisions. Additionally, the results indicate that financial performance itself significantly affects firm value, implying that the market rewards companies that exhibit stable and strong financial results. Importantly, financial performance was found to partially mediate the relationship between ESG and firm value, indicating that one of the pathways through which ESG enhances firm value is by strengthening financial performance. These findings provide empirical support for integrating ESG practices into corporate strategy, reinforcing that sustainability initiatives not only fulfill ethical and regulatory expectations but also contribute to measurable economic outcomes.

From an academic and practical standpoint, this study contributes to the literature by clarifying the mechanisms linking ESG, financial performance, and firm value. Practitioners are encouraged to consider ESG investments as part of long-term value creation strategies. However, the research has limitations, notably in its sample scope and contextual generalizability, which may constrain the applicability of the results across different industries or geographic regions. Future research should explore these relationships in broader and more diverse settings and consider additional moderating or mediating variables to deepen understanding of how ESG influences firm outcomes over time. By acknowledging these limitations and proposing concrete directions for future investigation, the study situates itself within an ongoing academic dialogue on sustainable corporate performance.

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