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ESG and firm value: The moderating role of firm-specific contexts in Indonesia

Adelia Vanessa[a], Senny Harindahyani[a]*, Rizky Eriandani[a]

[a]School of Accounting, Faculty of Business and Economics, Universitas Surabaya, Indonesia (senny.h@staff.ubaya.ac.id)
*Corresponding author

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Abstrak

Tujuan – Penelitian ini bertujuan untuk menganalisis pengaruh kinerja *environmental, social, and governance* (ESG) terhadap nilai pasar perusahaan, dengan mempertimbangkan konteks spesifik perusahaan berupa risiko penurunan (downside risk) dan potensi peningkatan (upside potential).

Metode – Penelitian menggunakan pendekatan kuantitatif dengan data perusahaan yang terdaftar di Bursa Efek Indonesia periode 2018–2022 dan memiliki skor ESG pada S&P Global Ratings. Sampel penelitian sebanyak 176 *firm years* yang dianalisis menggunakan regresi moderasi.

Temuan - Hasil penelitian menunjukkan bahwa kinerja ESG berhubungan negatif dengan nilai pasar perusahaan. Namun, risiko keuangan dan risiko lingkungan mampu memoderasi hubungan tersebut dengan mengurangi dampak negatif ESG terhadap nilai perusahaan. Sebaliknya, stabilitas keuangan dan pertumbuhan penjualan tidak terbukti memoderasi pengaruh ESG terhadap nilai pasar.

Implikasi - Temuan ini memberikan kontribusi teoretis dengan memperluas literatur mengenai respon investor terhadap ESG di negara berkembang, serta implikasi praktis bagi manajer dan investor dalam mempertimbangkan ESG sebagai mekanisme manajemen risiko.

Kebaharuan - Studi ini menawarkan kebaruan dengan menunjukkan bahwa, berbeda dengan banyak temuan di negara maju yang menekankan dampak positif ESG, investor di Indonesia justru merespons negatif kecuali dalam konteks risiko tinggi, sehingga menegaskan pentingnya konteks spesifik perusahaan.

Abstract

Purpose – This study aims to examine the impact of environmental, social, and governance (ESG) performance on firm market value, while incorporating firm-specific contexts such as downside risk and upside potential as moderating variables.

Methods – A quantitative approach was employed, using data from firms listed on the Indonesia Stock Exchange during 2018–2022 that had ESG scores from S&P Global Ratings. A total of 176 firm years were selected and analyzed using moderated regression analysis.

Findings - The results reveal a negative relationship between ESG performance and firm value. However, financial risk and environmental risk significantly mitigate the negative impact of ESG on firm value, while financial stability and sales growth do not moderate the relationship. These findings emphasize that investors in emerging markets perceive ESG differently than those in developed economies.

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Implications - This research provides theoretical implications by enriching the literature on investor responses to ESG in developing countries, and practical insights for managers and investors in using ESG as a risk management tool..

Originality - Unlike prior studies in developed markets that highlight ESG's positive role, this study shows that Indonesian investors tend to view ESG negatively unless it serves as an effective risk-reduction mechanism, highlighting the importance of firm-specific contexts.

INTRODUCTION

Over time, companies are increasingly engaging in social, environmental, and governance (ESG) activities, recognizing their importance and the potential benefits they bring. These activities are instrumental in supporting a company's long-term sustainability by conserving resources. One of the significant benefits of ESG activities is their potential to bolster a company's reputation, a factor that is highly regarded by the public. The disclosure of social and environmental responsibility, along with adherence to government regulations, is expected to yield a positive market response. This research aims first to determine the impact of ESG performance on the market value. Second, it seeks to analyze the effect of firm-specific context, downside risk, and upside potential on the relationship between ESG's performance and the company's value.

Much research on ESG and the company's market value has been done before, but the results are inconsistent (Flammer, 2018; Price & Sun, 2017). Some studies have argued that ESG increases the value of a company by supporting the "doing well by doing good" movement (Buchanan et al., 2018), building a company's reputation, and showing good intentions toward its members (Bardos et al., 2020), Increasing customer confidence (Saeidi et al., 2015), improving employee spirit and productivity (Kim & Keane, 2024), as well as lowering company risk (Albuquerque et al., 2019). However, ESG does not always result in an increase in market value in the eyes of investors. Investors will appreciate a high ESG when the company's specific context implies that companies with a high ESG score have a low risk (Lu et al., 2021). Marsat & Williams (2013) stated that ESG requires consumption over resources allocated to social and environmental responsibility-related activities. As a result, the company requires an increasing number of resources to enhance the core of its business (Wang & Bansal, 2012). Furthermore, when investors consider that the costs spent are more than the benefits obtained, ESG negatively impacts the company's market value (Dhananjaya, 2023).

Investor views of ESG vary depending on the company's specific context (Brealey et al., 2014). This study explores how a company's risk level and potential profits will affect investor perception of the ESG performance value. For instance, consider a company in the energy sector with high environmental risk and potential for high profits. Investors in this case would likely view ESG as a valuable risk reduction strategy. However, if the same company operates in a low-risk sector, investors might perceive ESG as a waste of resources. This underscores the importance of considering the specific context of the company in evaluating ESG performance. Similarly, an investor may assess ESG positively if it contributes to the growth and profitability of the company, such as a tech company with low risk and high potential profits investing in renewable energy (Lu et al., 2021). In short, investors evaluate the impact of ESG performance on the value of a company by considering the specific context of the company, a thoughtful and considerate approach to analysis.

This study contributes to the ESG literature in two important ways. First, while the majority of prior empirical evidence from developed markets suggests that ESG performance enhances firm value, our findings reveal a contrasting pattern in an emerging market context. Specifically, we show that investors in Indonesia tend to perceive ESG activities as value-destroying unless these activities function as mechanisms for mitigating financial or environmental risks. This highlights the importance of institutional and market differences in shaping how capital market participants value ESG. Second, the study advances the debate on firm-specific contingencies by demonstrating that downside risk factors, such as financial and environmental risk, significantly moderate the ESG–value relationship, whereas upside potential factors, including financial stability and sales growth, do not. By clarifying when and why investors reward ESG performance, this research provides both theoretical insights and practical implications for managers, investors, and policymakers in emerging markets, equipping them with actionable insights.

In an efficient market, prices will quickly reflect new information, making it very difficult to obtain higher returns consistently. However, the potential for investors to obtain sufficient returns to

compensate for the time value of the money and the risk incurred is promising. Investors can access and respond to all relevant information to assess, including CSR performance (Brealey et al., 2014). Investors use a variety of sources to obtain information about how companies manage risks and opportunities, and financial reporting is at the top of the list. Investors' concerns about 'greenwashing', a practice where companies overstate their environmental or social responsibility efforts to appear more sustainable than they are, undermine trust in what companies say about dealing with the sustainability risks and opportunities they face. These concerns also make it difficult for investment professionals to allocate capital according to their needs. As exposure to the threat of climate change increases, investors know what actions companies can take to manage risk effectively. However, according to PricewaterhouseCoopers (PwC, 2022), investors are unwilling to accept lower rates of return on investments in companies that engage in activities that benefit the community or the environment.

According to the Efficient Market Hypothesis (Brealey et al., 2014), stock prices incorporate all relevant information, including corporate social and environmental activities, enabling investors to evaluate a firm's ability to manage risks and opportunities. From a stakeholder perspective, ESG initiatives are not merely philanthropic activities but mechanisms to align the interests of multiple parties, reduce conflicts, and enhance firm legitimacy (Freeman, 1984). By building trust with employees, customers, regulators, and local communities, ESG can improve both internal efficiency—such as reducing turnover and strengthening governance—and external efficiency through reputation and competitive positioning (Flammer & Luo, 2017; Bardos et al., 2020).

ESG practices may also contribute directly to shareholder wealth. Prior studies indicate that ESG can reduce operational risks, attract socially responsible investors, and improve access to capital, all of which support higher firm valuation (Friede et al., 2015). Consistent with this view, Eriandani & Winarno (2023) argue that ESG activities can create company value by maximizing shareholder profits, showing that ESG is not only consistent with stakeholder interests but also with long-term shareholder value creation. Thus, by signaling a credible commitment to sustainability and strengthening both financial and non-financial performance, ESG activities are expected to enhance market valuation.

H_1: ESG performance has a positive impact on firm market value

The ability to meet financial obligations and obtain finance is related to the company's financial risk. High financial risk arises when a company is unable to meet its long-term obligations, indicating an increased likelihood of financial distress or bankruptcy. Cheng et al. (2014) and Oikonomou et al. (2012) found that high ESG performance effectively reduces the company's financial risk. Oikonomou et al. (2012) found that companies will have higher financial risks if they are not socially responsible, while companies will have lower financial risks if they are socially responsible. Cheng et al. (2014) and Oikonomou et al. (2012) proposed that investors, who play a crucial role in determining the market value of companies, will tend to perceive that ESG can increase value by reducing financial risk if a company faces a high level of financial risk. Companies that operate at higher financial risk require greater investment in risk mitigation, as they are more likely to benefit from such efforts. In contrast, companies with lower financial risks have less need for risk mitigation, making it less likely that investments in this area will yield significant benefits. Consequently, in high-risk situations, investors tend to recognize high ESG performance as an effective risk reduction strategy, resulting in a positive reaction and an increase in perceived value.

Investors interpret strong ESG performance in financially risky firms as a credible signal of effective risk management, which enhances access to external financing and reduces the cost of capital (Lu et al., 2021). Conversely, firms with low financial risk derive fewer marginal benefits from ESG as a risk reduction mechanism, leading investors to perceive ESG efforts as less value-enhancing. Therefore, the value of ESG performance is contingent on the firm's financial risk profile: the higher the risk, the more investors appreciate ESG as a mitigating strategy.

H_2: Financial risk strengthens the influence of ESG on market value.

Environmental risk, the potential losses and liabilities that arise from firms negatively impacting the natural environment, is a significant concern for companies in environmentally sensitive industries. These industries, such as mining, energy, and chemicals, are particularly vulnerable to lawsuits, regulatory sanctions, and reputational damage. In contrast, firms in low-impact sectors, such as banking, face relatively lower environmental risks (Orlitzky et al., 2011). ESG initiatives play a crucial role in mitigating such risks by ensuring compliance with environmental standards and promoting sustainable

practices. The strong performance of ESG initiatives reduces the probability of environmental incidents, thereby enhancing safety measures, and minimizes litigation costs, thereby serving as an effective environmental risk management mechanism (Sharfman & Fernando, 2008). ESG also provides an "insurance-like effect" by buffering firms from the negative financial impact of environmental crises (Godfrey et al., 2009; Shiu & Yang, 2017).

From an investor's perspective, the value attributed to ESG performance is heavily influenced by a firm's environmental risk profile. In high-risk industries, investors are more likely to view ESG activities as essential risk mitigation tools that protect firm value and ensure business continuity. Conversely, in low-risk industries where exposure to environmental liabilities is minimal, the marginal benefits of ESG are smaller, and high ESG performance may even be perceived as an unnecessary cost (Cheng et al., 2014). Therefore, environmental risk plays a crucial role in shaping investor perceptions of ESG, conditioning the extent to which they reward ESG and amplifying the positive association between ESG performance and market value when environmental risks are high.Building on the preceding discussion, we propose the following hypothesis: Environmental risk strengthens the influence of ESG on market value. This hypothesis is based on the understanding that environmental risk conditions the extent to which investors reward ESG, amplifying the positive association between ESG performance and market value when environmental risks are high.

H_3: Environmental risk strengthens the influence of ESG on market value.

Financial stability reflects a firm's ability to generate consistent earnings over time, signaling resilience and sound resource management (Badrinath et al., 1989; Jain, 2007). According to Slack resource theory, firms with stable earnings possess surplus resources that allow them to invest in non-financial initiatives, including ESG, without jeopardizing their financial health (Boehe & Cruz, 2010). From a resource-based view, such firms can strategically allocate resources to ESG activities as a differentiation mechanism, enhancing reputation, legitimacy, and stakeholder trust. In this way, financial stability provides a foundation for ESG investments to translate into long-term value creation. Conversely, firms with unstable or weak earnings, lacking sufficient slack resources, face a different scenario. For these firms, ESG investments may appear as resource-draining commitments rather than value-enhancing strategies. This perception, as noted by McWilliams & Siegel (2001), could lead investors to view these firms as prioritizing non-essential activities at the expense of financial recovery, thereby seeing ESG as detrimental to firm value. Hence, the impact of ESG performance on market value is likely to be contingent on a firm's financial stability, with stronger positive investor responses expected when stability is high.

H_4: Financial stability strengthens the influence of ESG on market value.

Sales growth reflects a firm's market expansion and future revenue potential, signaling competitive strength and adaptability. Firms experiencing high sales growth are often better positioned to integrate ESG initiatives into their broader strategic trajectory, as they have the organizational capabilities and resources to capitalize on sustainability-oriented innovation Bocquet et al. (2017). From the perspective of dynamic capabilities, these firms can leverage ESG not only to build legitimacy with stakeholders but also to reinforce their growth strategies, thereby increasing their attractiveness to investors. On the other hand, firms with weak or stagnant sales growth may find it challenging to derive tangible financial benefits from ESG practices. However, for firms with robust sales growth, the story is different. ESG investments can be a strategic move, not just discretionary expenditures. They can create significant value, enhancing market value and attracting investors. This underscores the potential of ESG practices to be a game-changer for firms with strong sales growth.

H_5: Sales growth strengthens the influence of ESG on market value.

METHODS

This research adopts a quantitative approach within the positivism paradigm, employing quantitative data collection methods. The study is a hypothesis test aiming to shed light on how investors evaluate environmental, social, and governance factors based on market valuations and the company's specific context. The sample for this study was carefully selected based on two critical criteria: firstly, companies listed on the Indonesian Stock Exchange for 2018-2022. Secondly, it has a rating in S&P Global Ratings ESG Evaluation. This meticulous process yielded a sample of 176 firms years, providing a comprehensive and highly relevant dataset for our analysis.

The testing of hypotheses was done using moderated regression analysis, a powerful regression model that predicts a relationship between related variables, and is particularly useful in our study due to its ability to account for potential moderating factors.

$$MVi,t = \alpha + \beta_1 ESGi,_t + \beta_2 ROAi,_t + \beta_3 Sizei,_t + \beta_4 AGEi,_t + \beta_5 CIi,_t + ei,_t \quad (1)$$

$$MVi,t = \alpha + \beta_1 ESGi,_t + \beta_2 FRi,_t + \beta_3 ERi,_t + \beta_4 FSi,_t + \beta_5\, SGi,_t + \beta\beta_6 ROAi,_t + \beta_7 Sizei,_t + \beta_8 AGEi,_t + \beta_9 CIi,_t\, ei,_t \quad (2)$$

$$MVi,t = \alpha + \beta_1 ESGi,_t + \beta_2 FRi,_t + \beta_3 ERi,_t + \beta_4 FSi,_t + \beta_5\, SGi,_t + \beta_6 ESGxFRi, + \beta_7 ESGxERi,_t + \beta_8 ESGxFSi,_t + \beta_9 ESGxSGi,_t + \beta_{10} ROAi,_t + \beta_{11} Sizei,_t + \beta_{12} AGEi,_t + \beta_{13} CIi,_t + ei,_t \quad (3)$$

MV refers to the market value or the whole value of a corporation. ESG stands for environmental, social, and governance. FR is a financial risk. Environmental risk (ER) is a significant concern related to the environment. FS stands for financial stability. SG stands for sales growth. ROA stands for return on assets. Size refers to the dimensions or magnitude of a company. AGE refers to the duration of time a company has existed. CI stands for capital intensity.

Table 1. Variables Definition and Measurement

Variables	Measurement	Description
Firm Value	Tobin's Q (MV)	Tobin's Q is defined as the equity market value and the total debt book value divided by the total asset book value (Ciftci et al., 2019).
Environmental social governance	ESG	ESG performance is measured using S&P Global Ratings ESG Evaluation
Downside Risk	Financial Risk (FR)	Leverage is the ratio of total debt divided and the total assets (Sheikh & Wang, 2011).
	Environmental Risk (ER)	Environmental risk is categorized into two distinct types: high-profile industries and low-profile industries.
Upside Potential	Financial Stability (FS)	Financial stability is calculated using the ACHANGE proxy, representing a presentation of asset changes over two years (Himawan & Karjono, 2019).
	Sales Growth (SG)	Sales growth calculated by dividing the difference between the current year's sales and the previous year's sales by the current year's sales (Lu et al., 2021)
	ROA	The Return on Assets (ROA) is calculated by dividing the net income by the total assets.
Control Variable	Firm Size (SIZE)	The size of the corporation is determined by calculating the natural logarithm of its total assets.
	Company Age (AGE)	AGE refers to the duration in years since the establishment of the company (Dezsö & Ross, 2012).
	Capital Intensity (CI)	Capital intensity refers to the level of investment in fixed assets (Adiputri & Wati, 2021).

Table 1 presents a summary of the variable measurements. Market value (MV) is quantified using Tobin's Q. The S&P Global Ratings ESG Evaluation assesses ESG performance. The S&P Global Ratings ESG Evaluation is a comprehensive analysis of a company's environmental, social, and governance (ESG) strategy and its ability to effectively manage and respond to possible risks and opportunities that may arise in the future. S&P Global ESG evaluates a company's ability to handle significant environmental, social, and governance risks, opportunities, and effects effectively. The scoring system ranges from 0 to 100, and points are awarded based on a pre-established assessment that evaluates the company's availability, quality, relevance, and performance in sustainability subjects. Companies with this S&P Global ESG score are respondents to the company's sustainability assessment survey. ESG scores are determined by evaluating organizations' replies to the assessment and publicly available information. Organizations undergo assessment through a questionnaire and the Corporate Sustainability Assessment (CSA) methodology. The financial risk associated with adopting leverage can be measured using the leverage proxy, which is calculated by dividing total debt by total assets (Sheikh & Wang, 2011). Environmental Risk Assessment aims to assess the effects of stressors, often chemicals,

on the local environment. Risk is an integrated assessment of the likelihood and severity of undesirable events. Environmental risk within a corporation is categorized into two distinct types: high-profile industries and low-profile industries. Hackston & Milne (1996) conducted research that classified certain companies as high-profile and others as low-profile. High-profile companies include oil and other mining companies, chemicals, forests, paper, automotive, aviation, agribusiness, tobacco and cigarettes, food and beverage products, media and communications, energy (electricity), engineering, health, and transportation and tourism. On the other hand, low-profile companies are construction companies, finance and banking, medical equipment suppliers, property and retail companies, textiles and textile products, personal products, and household products. This study assigns a score of 0 to companies categorized as low-profile industries and 1 to companies categorized as high-profile industries. Financial stability refers to a company's finances being secure and steady. Financial stability is assessed by utilizing the ACHANGE proxy, which measures the percentage change in assets over two years (Himawan & Karjono, 2019). Sales growth is calculated by dividing the change in sales from the previous year to the current year by the current year's sales (Lu et al., 2021).

RESULTS AND DISCUSSION

Results

Table 2 shows the results of descriptive statistics. As the dependent variable, firm value (MV) has a minimum value of 0.57 and a maximum value of 14.47. The average firm value of all companies is 1.97. The independent variables used for this study are ESG, financial risk, environmental risk, financial stability, and sales growth. The ESG variable has a minimum value of 2 and a maximum value of 63. The average ESG of all companies is 20.06. The financial risk variable has a minimum value of 0.4 and a maximum value of 0.98. The average financial risk of all companies is 0.52. In the ER or Environmental risk variable, the minimum value is 0, and the maximum value is one because this variable uses a dummy so that there are many companies that have a low-risk profile industry will get a value of 0, and companies that have a high-profile industry will get a value of 1. The average of the Environmental risk variable is 0.8. The financial stability variable has a minimum value of -0.40 and a maximum value of 51.11. The average of the financial stability variable of all companies is 0.50. The minimum value of the sales growth variable is -0.92, and the maximum is 0.76. The average of all companies is 0.065.

Table 2. Descriptive Statistics

Variables	N	Minimum	Maximum	Mean	Std. Deviation
MV	176	0.57	14.47	1.98	1.82
ESG	176	2.00	63.00	20.06	10.93
FR	176	0.04	0.98	0.52	0.24
ER	176	0.00	1.00	0.80	0.41
SF	176	-0.40	51.11	0.50	3.92
SG	176	-0.92	0.76	0.07	0.21
ROA	176	-0.18	0.30	0.06	0.06
SIZE	176	28.00	35.00	31.90	1.42
AGE	176	6.00	127.00	43.82	22.16
CI	176	0.13	60.15	4.52	7.52

This study uses classical assumption tests, namely normality, heteroscedasticity, autocorrelation, and multicollinearity, to fulfill the statistical requirements for conducting multiple linear regression analysis. After conducting the classical assumption test, we delve into the process of hypothesis testing using the moderated regression analysis method. This method, while complex, is a powerful tool in our research arsenal. It allows us to answer the hypothesis that has been proposed and to determine the relationship between dependent and independent variables with confidence.

The empirical results of the three models are presented in Table 3. The results from models (1) and (3) indicate that Environmental, Social, and Governance (ESG) factors have a substantial adverse impact on the value of the company (MV), hence leading to the rejection of hypothesis H1. In models (2) and (3), the coefficients of the downside risk variables, namely Financial risk (FR) and Environmental

risk (ER), constantly exhibit negative values. This result implies that when the company risk increases, the company value has a corresponding negative effect. In contrast, models (2) and (3) indicate that the variables representing the potential for growth - financial stability (FS) and sales growth (SG), do not exert a substantial influence on the value of the company. Furthermore, in the model (3), the interaction variables ESG*FR and ESG*ER show positive and significant coefficients, meaning that FR and ER can moderate the relationship between ESG and market value. It should be noted that the relationship between ESG and MV has a negative coefficient. At the same time, when the FR or ER variables are entered as moderating variables, ESG*FR and ESG*ER show positive coefficients. This shows that downside risk weakens the negative impact of ESG on firm value; therefore, H2 and H3 are accepted. Furthermore, the interaction variables ESG*FS and ESG*SG show positive and insignificant coefficients, meaning that FS and SG cannot moderate the effect of ESG on market value. It is concluded that H4 and H5 are rejected.

Table 3. Regression Results

Variables	Tobin's Q		
	(1)	(2)	(3)
C	29.992***	19.734***	31.157***
	(7.659)	(8.475)	(10.965)
ESG	-0.036***	-0.011	-0.241***
	(-1.903)	(-1.144)	(-4.065)
FR		-1.722***	-4.558***
		(-3.504)	(-3.269)
ER		-1.431***	-2.301***
		(-4.169)	(-3.365)
FS		-0.015	-0.104
		(-0.776)	(-0.595)
SG		-0.065	0.641
		(-0.174)	(0.543)
ESGxFR			0.281***
			(4.120)
ESGxER			0.110***
			(3.472)
ESGxFS			0.003
			(0.465)
ESGxSG			-0.063
			(-1.066)
ROA	14.046***	2.768***	12.634***
	(7.444)	(2.343)	(7.303)
SIZE	-0.937***	-0.498***	-0.825***
	(-7.300)	(-6.413)	(-9.182)
AGE	0.031***	0.001	0.006
	(3.718)	(0.118)	(1.243)
CI	0.130***	0.006	0.122***
	(5.581)	(0.321)	(6.513)
n	183	175	176
Adj. R^2	0.473	0.573	0,613
F stat.	33.607***	15.622***	22.297***

Note: ***sig.<0.01, **sig.<0.05, *sig.<0.1

Discussion

Our findings reveal that ESG performance negatively affects firm market value, which is consistent with the results of Garcia & Orsato (2020), who showed that ESG scores are negatively related to financial performance in emerging markets. In the Indonesian context, several institutional factors may explain why investors respond differently to ESG compared to their counterparts in developed markets. First, the level of ESG literacy among domestic investors remains relatively low, limiting their ability to interpret sustainability disclosures as value-relevant information. Second, ESG reporting standards in Indonesia are still evolving and often lack the depth and comparability of international benchmarks, which reduces investor confidence in the quality of disclosures. Third, regulatory enforcement of sustainability practices remains weak, allowing firms to adopt ESG symbolically without

substantive changes. This outcome aligns with agency theory, as investors may perceive ESG initiatives as a diversion of scarce resources away from core business operations (McWilliams & Siegel, 2001; Wang & Bansal, 2012). Husnaini et al. (2018) further argue that ESG activities often strengthen internal foundations without delivering visible returns to investors, leading to the perception of ESG as a wasteful practice rather than a value-creating one. In the Indonesian context, weak enforcement, low ESG literacy, and concerns about greenwashing may exacerbate this perception, reducing the credibility of ESG disclosures and leading investors to discount their value. In conclusion, while global literature often emphasizes ESG as a value-enhancing mechanism, in developing countries like Indonesia, investors still tend to respond negatively. This suggests the urgent need for firms to improve the transparency and credibility of ESG reporting, thereby transforming it from a perceived drain on resources to a genuine driver of long-term financial success.

The results show that financial risk strengthens the positive influence of ESG on market value. This finding highlights the contextual nature of ESG, as prior research shows that ESG does not consistently improve financial results (Masulis & Reza, 2015) and may even reduce firm value in certain circumstances (Garcia & Orsato, 2020). It is therefore important to identify the conditions under which investors respond positively to ESG. Our study suggests that ESG plays a role as a risk management mechanism, mitigating the likelihood of financial distress and enhancing firms' capacity to generate future profits. The empirical evidence from model (3) in Table 4 confirms that the interaction of ESG and financial risk significantly improves firm value, consistent with Lu et al. (2021), who demonstrate that ESG becomes particularly valuable when financial risk is high. Similarly, Lins et al. (2017) show that firms with strong ESG performance outperform their peers during financial crises, supporting the view that ESG functions as an "insurance-like effect" (Godfrey et al., 2009). Investors appear to reward ESG as a credible signal of effective risk mitigation when firms face elevated risk exposure, but perceive little benefit when financial risk is minimal, in which case ESG may even reduce firm value.

We find that environmental risk positively moderates the ESG–value relationship, indicating that ESG is especially valuable in high-risk industries such as mining or energy. When firms face significant environmental hazards, investors respond more favorably to ESG performance, as it signals proactive efforts to manage potential liabilities and reputational damage. This is consistent with prior research showing that strong ESG practices reduce the likelihood of environmental losses and associated costs from legal disputes and compliance obligations, thereby safeguarding cash flows (Lu et al., 2021; Shiu & Yang, 2017). From the environmental liability perspective, ESG serves as a protective barrier or "insurance-like effect" that significantly buffers firms against the adverse financial consequences of environmental crises, ensuring their financial resilience (Godfrey et al., 2009). However, this perception is not universal: in low-risk industries, the marginal benefits of ESG are limited, and investors may view extensive ESG initiatives as excessive or unnecessary. Thus, the value investors place on ESG depends heavily on a firm's environmental risk profile, with stronger positive responses observed when risk exposure is high.

In the specific context of companies in potential conditions (upside potential), which are typically characterized by significant improvements in a company's performance, the interaction of ESG and financial stability does not affect the company's value. This is supported by previous research, namely Polii & Herawaty (2020), which states that financial stability does not strengthen the influence of ESG on company value. Financial stability, despite being a crucial aspect of a company's performance, is not included in the category of potential upside conditions as it is considered a baseline requirement for any company. Therefore, it cannot be a moderating variable between ESG performance and the company's market value. Likewise, the condition of potential sales growth, while important for a company's future prospects, is not considered a potential upside condition as it is often unpredictable and can vary significantly across industries. Therefore, it cannot moderate the relationship between ESG and market value. This is supported by previous research, namely Lu et al. (2021), the moderating variable of sales growth cannot moderate the effect of ESG performance on the company's market value; even in the article, additional testing was carried out by extending the sales growth period of 3-5 years but the results were still unable to moderate. Investors do not consider sales growth as a potential that can increase ESG value.

Investors will perceive ESG as a value enhancer. However, when the company's specific context does not require high ESG performance, investors will perceive ESG as a value destroyer. Empirical results show that ESG performance will increase market value if the company has high risk. In other words, investors will appreciate an efficient risk reduction strategy for companies facing risk. However,

suppose the company operates in a low-risk condition. In that case, the risk protection mechanism provided by ESG is not appreciated by investors, resulting in a negative evaluation of high ESG performance. Specifically, in Indonesia, although the government has begun to try to improve ESG to achieve sustainability, Indonesian investors consider ESG to be an effective risk reduction mechanism when the company's specific context (high risk) determines the need for such a mechanism.

CONCLUSION

This study examined the role of environmental, social, and governance (ESG) performance in influencing firm market value, with financial risk, environmental risk, financial stability, and sales growth as moderating variables, using data from companies listed on the Indonesia Stock Exchange between 2018 and 2022. The results indicate that ESG performance, in general, has a negative relationship with market value. However, when investors assess ESG through its role in risk reduction—particularly in relation to financial and environmental risks—ESG is positively associated with firm value, whereas its effect through upside potential factors, such as financial stability and sales growth, is not significant. These findings underscore the importance of viewing ESG primarily as a mechanism for risk mitigation in emerging markets, offering valuable insights for managers and investors in aligning sustainability practices with financial strategies.

Despite its contributions, the study has several limitations. The sample was restricted to firms with S&P Global Ratings ESG scores, which may bias the results toward larger or more visible firms. In addition, the moderating variables were limited to financial risk, environmental risk, financial stability, and sales growth, leaving out other potentially relevant factors. Future research should therefore extend the sample to cover all firms listed on the IDX over a longer time horizon, explore alternative ESG measurement proxies to enhance robustness, and incorporate additional moderating variables such as operational risk, reputational risk, or innovation capacity. Expanding research in these directions will provide a more comprehensive understanding of how ESG performance shapes firm value in emerging markets.

STATEMENT OF COMPETING INTEREST

The authors declare no competing interests. This research did not receive any specific grant from funding agencies in the public, commercial, or not - for - profit sectors.

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