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DOES ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) EFFECT ON FIRM VALUE: MODERATE WITH CAPITAL STRUCTURE

By

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Abstract
The increasing global awareness of sustainability issues regarding environmental, social, and governance (ESG) factors has become an important concern in the business world. Companies are expected to pay more attention to and integrate ESG into their business strategies to achieve sustainable growth and enhance firm value. This study aims to examine the impact of environmental, social, and governance (ESG) performance on firm value by involving capital structure as a moderating variable. The research uses a sample of 490 from 67 non-financial sector companies listed on the Indonesia Stock Exchange with an observation period from 2014 to 2023. Data analysis employs panel data regression using Eviews 12 and SPSS 16. The research findings indicate that ESG performance negatively affects firm value. Furthermore, the relationship between ESG and firm value cannot be moderated by capital structure. These findings provide new insights for managers and stakeholders regarding the importance of careful evaluation of ESG implementation in corporate strategies. This research also highlights the need for a more in-depth approach to understanding the factors that can enhance the Firm's value in the context of sustainability.

Keyword: Environmental, Social and Governance; ESG; Firm Value; Capital Structure

Introduction

The increase and decrease in firm value often occur from year to year. Maintaining firm value is crucial because an increase in firm value enhances the welfare of stakeholders.(Putu et al., 2024) To enhance firm value, companies should not only focus on maximizing profits but also pay attention to the internal and external interests of stakeholders. (Worokinasih et al., 2020)

Prayogo et al. (2023) stated that one of the key factors in increasing firm value is maintaining long-term company sustainability by implementing good corporate governance and addressing sustainability issues, such as environmental, social, and governance (ESG). The global awareness of sustainability issues related to ESG factors has become a significant focus in the business world. Companies are expected to pay more attention to and integrate ESG into their business strategies to achieve sustainable growth and increase their value. Environmental, Social, and Governance (ESG) is a concept that considers environmental, social, and governance issues to create sustainable businesses. On the other hand, ESG is described as a series of factors used to measure a company's sustainability performance in the areas of environment, social, and corporate governance. Mantzanas (2023)

Legitimacy theory plays a crucial role in the context of ESG and firm value. This theory suggests that companies must operate in accordance with societal norms and values to gain legitimacy. Disclosing information related to ESG is one way for companies to demonstrate their commitment to social responsibility, enhancing the company's image and reputation in the eyes of stakeholders. Ningwati et al. (2022) Legitimacy theory implies that companies should reduce the expectation gap with society to improve legitimacy (recognition) from stakeholders. (Gunawan & Apriwenni, 2019)

This aligns with stakeholders' theory, which states that companies have a responsibility to benefit stakeholders, not just shareholders but society at large. This theory emphasizes the importance of companies addressing stakeholders' needs and expectations. ESG practices can help companies provide complete and accurate

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information on sustainability aspects, fulfilling stakeholders' rights to obtain information on the sustainability aspects of the company's operations. (Agustina & Pradesa, 2024)

Research on the relationship between ESG and firm value has gained increasing attention over the last five years. This is due to ESG's ability to guide companies, investors, and policymakers in making better decisions regarding long-term sustainability and corporate responsibility towards environmental, social, and governance factors.

Melinda & Wardhani (2020) found that ESG index scores statistically significantly affect firm value. This study also demonstrated that ESG-environmental, ESG-social, and ESG-governance individually influence firm value. A good ESG score can attract investors because ESG is considered capable of mitigating investment risks. Similarly, El-Deeb et al. (2023) found that ESG positively and significantly impacts firm value. This research states that by meeting the needs and expectations of various stakeholders and gaining societal legitimacy and support, a company's ESG performance positively affects its reputation, brand image, and financial performance.

Duan et al. (2023)), who stated that strong ESG performance positively influences firm value. This study highlights that robust ESG performance can help reduce financial constraints, thus increasing firm value. Meanwhile, research conducted on 591 companies in Canada, France, Germany, Italy, the United Kingdom, Japan, and the United States found that ESG reporting positively affects firm value (Azimli & Cek, 2024)

However, some studies present different results. Rastogi et al. (2024) found that the linear relationship between a company's ESG score, and firm value was not significant. This is attributed to high investor interest, which hinders the impact of ESG on firm value. Additionally, Kumari et al. (2022) found no significant relationship between overall and individual ESG components and firm value. Al-Hiyari & Kolsi (2021) discovered that ESG-environmental had no relevant effect on firm value, while ESG-social and ESG-governance had a significant impact.

This study uses capital structure as a moderating variable. This is based on research by Wahyuni (2018), which stated that capital structure moderates the relationship between corporate governance and firm value. When a company discloses corporate governance to stakeholders and provides details about the capital used, it influences firm value. This is because if a company's debt exceeds its equity, the company will prioritize fulfilling its obligations. This study also includes control variables, such as profitability measured by Return on Assets (ROA), to reduce potential bias in the results by ensuring that the influence of other variables is minimized.

Literature Review and Hypothesis

Environmental, Social and Governance (ESG) and Firm Value

ESG performance has become an increasingly important topic in the modern business world. Research indicates that good ESG performance has a significantly positive impact on a company's value. Factors such as reduced funding constraints, improved operational efficiency, and decreased financial risks play key roles in creating sustainable long-term value.

Companies with good ESG performance tend to have easier access to capital at lower costs. Investors and financial institutions are paying closer attention to sustainability practices in their investment decision-making processes. This is because companies with strong ESG performance are considered more stable and less risky, which helps reduce the cost of capital and increase profitability(Wu et al., 2022)

Companies that focus on sustainability often find ways to reduce waste, enhance resource usage, and optimize production processes. For instance, companies that implement environmentally friendly practices can lower energy and raw material costs, ultimately improving profit margins. With higher efficiency, companies can reinvest in innovation and product development. A study on manufacturing companies in China by Duan et al. (2023) shows that good ESG performance increases a company's value. These findings align with stakeholder theory (Freeman, 1984)emphasizing the importance of corporate responsibility to various stakeholders. By addressing ESG aspects, companies can gain greater support from stakeholders and foster mutually beneficial relationships.

Rastogi et al. (2024) highlight that consumers and investors are increasingly attentive to corporate social responsibility. Companies that neglect ESG aspects risk losing reputation and market share. By integrating ESG practices into business strategies, companies can enhance their reputation, attract investors and consumers, and achieve higher market value. Melinda & Wardhani (2020) demonstrate that ESG index scores and controversy scores significantly affect firm value. The three ESG pillars – environmental, social, and governance – contribute to increased market value.

Meanwhile, El-Deeb et al. (2023) reveal that ESG disclosure on the Egyptian Exchange (EGX) from 2017–2021 significantly increased firm value. This study aligns with legitimacy theory, which posits that meeting stakeholder needs enhances reputation and brand image. (Deegan, 2019) According to Ruth et al. (2023), ESG implementation reduces information asymmetry and stakeholder conflicts. This aligns with agency theory, which explains the reduction of agency costs through non-financial information disclosure (Jensen & Meckling, 1976)

Aboud & Diab (2018) found that ESG information disclosure has a significantly positive relationship with firm value in Egypt. This study emphasizes the importance of ESG disclosure as a tool for building trust and legitimacy in the eyes of stakeholders. In this context, effective disclosure not only serves to meet regulatory obligations but also acts as a strategy to enhance corporate reputation and attract investor attention. Rahman & Alsayegh (2021)emphasize the importance of transparency in ESG information disclosure. Transparency strengthens corporate reputation, boosts customer loyalty, attracts investors, and creates a positive cycle that contributes to increased firm value.

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Overall, strong ESG performance provides financial benefits and creates broader positive impacts for society and the environment. By adopting sustainable ESG practices, companies can build a strong reputation, enhance customer loyalty, and create long-term value. In modern business, integrating ESG aspects into corporate strategy is not just a necessity but also an opportunity to achieve sustainable growth and societal well-being. Based on previous research, the hypotheses of this study are as follows:

H1: Environmental, Social, and Governance (ESG) performance affects firm value.

H1a: ESG performance – Environmental affects firm value.

H1b: ESG performance – Social affects firm value.

H1c: ESG performance – Governance affects firm value.

Capital Structure as Moderating on ESG and Firm Value

Capital structure is one of the important variables in financial research that can function as a moderating variable. Research by Wahyuni (2018) shows that capital structure moderates the relationship between corporate governance and firm value. In this case, capital structure serves as a link that strengthens or weakens the influence of corporate governance on firm value. When a company has a healthy and balanced capital structure, good governance can be more effective in enhancing firm value. Conversely, if the capital structure is not optimal, even good governance may not have a significant impact on firm value.

Agency theory provides a relevant framework to understand this relationship. This theory describes the relationship between the principal (owner) and the agent (management), where the principal appoints the agent to perform tasks or provide services on their behalf (Jensen & Meckling, 1976). In the context of capital structure, the company's owner (principal) relies on management (agent) to manage the company's resources in a way that can maximize firm value. However, there is a potential conflict of interest between the principal and agent, especially regarding decisions about capital structure. Management may have incentives to take on higher risks by using debt, which can increase potential returns but also raise the risk of bankruptcy.

Furthermore, the interaction between capital structure and ESG can also be influenced by external factors, such as market conditions and the economic environment. In favorable market conditions, companies may be more inclined to take on debt to finance expansion, whereas in unfavorable market conditions, companies may be more cautious in using debt. Therefore, it is essential to consider the external context when analyzing the relationship between capital structure, ESG, and firm value.

To test this hypothesis, further research is needed to explore how capital structure can moderate the relationship between various factors, including corporate governance. This research could also include an analysis of different industry sectors to understand how the impact of capital structure varies among different types of companies. In this way, a deeper understanding of the role of capital structure as a moderating variable can provide valuable insights for corporate management and stakeholders in strategic decision-making.

Overall, capital structure not only functions as a tool for financing company operations but also as a factor that can influence the relationship between ESG and firm value. By understanding the role of capital structure in this context, companies can develop more effective strategies to maximize firm value and achieve their long-term goals. Based on previous studies, the hypothesis of this research is:

H2: Capital Structure Moderates the Relationship Between Environmental, Social, and Governance (ESG) Performance and Firm Value.

Method

This research uses a quantitative study. Sugiyono (2009) states that the quantitative approach is based on the philosophy of positivism, which aims to analyze a certain population or sample using instruments and statistical analysis. This study was conducted on non-financial sector companies listed on the Indonesia Stock Exchange. From the population of all non-financial sector companies listed on the Indonesia Stock Exchange, the sample taken consists of 67 companies with a total of 490 observations (unbalanced panel data). This is because some companies did not have ESG score ratings by Financial Analysis Bloomberg.

This study uses panel data regression, which is a combination of cross-sectional data and time-series data. In other words, panel data refers to data from the same individuals observed over a certain period (Robinson Sihombing, 2021).

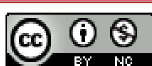
There are three types of tests to determine the panel data analysis technique. First, the F-statistic test or Chow test is used to decide between the Common Effects or Fixed Effects methods. Second, the Hausman test is used to choose between the Fixed Effects or Random Effects methods. Third, the Lagrange Multiplier test is used for other purposes in the analysis.

Result and Discussion

Descriptive statistic variable

Table 1 Descriptive Analysis

Variabel	N	Minimum	Maximum	Mean	Std. Deviation	Variance
Tobin's Q	490	.34	2.16	1.1384	.37584	.141
ESG	490	12.52	72.96	38.7250	13.18521	173.850



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Environmental	490	.00	75.35	22.5719	20.29095	411.723
Social	490	.00	58.62	23.9618	13.10814	171.823
Governance	490	34.92	98.62	69.5270	12.10758	146.594
DER	490	.00	2.53	.6407	.52134	.272
ROA	490	-.18	.28	.0437	.05345	.003

The results of the descriptive analysis of the research data show that the variable Tobin's Q, which represents market performance, has a minimum value of 0.34 and a maximum value of 2.16, with an average of 1.1384 and a standard deviation of 0.37584, indicating moderate variation among companies. The ESG (Environmental, Social, and Governance) variable has an average of 38.7250 with a standard deviation of 13.18521, reflecting a relatively high variation in the companies' ESG scores, with a minimum value of 12.52 and a maximum value of 72.96.

The ESG components were also analyzed separately. Environmental has an average of 22.5719 with a high standard deviation of 20.29095, indicating significant differences among companies regarding environmental responsibility. The minimum and maximum values are 0.00 and 75.35, respectively. Social shows an average of 23.9618 with a standard deviation of 13.10814, indicating moderate differences in the social aspect, with a minimum value of 0.00 and a maximum value of 58.62. The Governance component has the highest average among the three, at 69.5270, with a standard deviation of 12.10758, indicating relative stability in corporate governance practices, with a minimum value of 34.92 and a maximum value of 98.62.

Additionally, the DER (Debt to Equity Ratio) variable has an average of 0.6407, with a standard deviation of 0.52134, indicating that the companies' funding structures tend to vary. The minimum value is 0.00, while the maximum value is 2.53. The ROA (Return on Assets) variable, which reflects company profitability, shows an average value of 0.0437 and a low standard deviation of 0.05345, indicating relatively consistent performance among companies. The minimum ROA value is -0.18 and the maximum is 0.28.

The Data Panel Analysis Techniques

Based on Table 2, the result of the Chow test indicates that the P-value is 0.000 < 0.05. This means that the appropriate regression model is the fixed effect model. Therefore, the next test is the Hausman test.

Table 2 Chow Test

Redundant Fixed Effects Tests
Equation: Untitled
Test cross-section fixed effects

Effects Test	Statistic	d.f.	Prob.
Cross-section F	10.579325	(66,417)	0.0000
Cross-section Chi-square	482.029961	66	0.0000

Cross-section fixed effects test equation:

Table 3 Hausman Test

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	32.190894	6	0.0000

Based on table 3 the results of the Hausman test, the p-value is 0.000 < 0.05, Thus, these results suggest that the fixed effect model is more suitable for use in this data analysis, as it indicates that there is a correlation between the independent variables and the unobserved individual effects.

Hypothesis Test

Table 4 T- Test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.529378	0.050805	30.10270	0.0000
ESG	-0.012141	0.001246	-9.740673	0.0000
ROA	1.811589	0.275076	6.585776	0.0000

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.689851	0.112290	15.04901	0.0000
ENVIRONMENTAL	-0.003281	0.001224	-2.680649	0.0076
SOSIAL	-0.003188	0.001928	-1.653384	0.0990
GOVERNANCE	-0.006893	0.001846	-3.733222	0.0002
ROA	1.789774	0.275879	6.487539	0.0000

The regression results show that the constant (C) is 1.529378, indicating the intercept of the model. The ESG variable has a coefficient of -0.012141, meaning each unit increase in ESG reduces the dependent variable by 0.012141, with high statistical significance (t-statistic = -9.740673, p = 0.0000). The ROA variable has a coefficient of 1.811589, indicating that each unit increase in ROA raises the dependent variable by 1.811589, also highly significant (t-statistic = 6.585776, p = 0.0000).

The second regression shows that the constant (C) is 1.689851. The Environmental variable has a negative significant effect (coefficient = -0.003281, p = 0.0076). The Social variable is not significant (coefficient = -0.003188, p = 0.0990). The Governance variable has a negative significant effect (coefficient = -0.006893, p = 0.0002). Finally, ROA has a significant positive effect (coefficient = 1.789774, p = 0.0000). In summary, Environmental, Governance, and ROA significantly affect the dependent variable, while Social does not.

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Table 5 R^2-Test

R-Squared	0,679568
Adjusted R-Squared	0,626035

The results of the coefficient of determination test show an R-squared value of 0.679568 and an Adjusted R-squared value of 0.626035. The R-squared value of approximately 0.68 indicates that around 67.96% of the variation in the dependent variable can be explained by the independent variables in the model. Meanwhile, the lower Adjusted R-squared value of 0.626035 suggests that after accounting for the number of variables in the model, around 62.60% of the variation can still be explained. This indicates that while the model is quite good at explaining data variation, there may be some independent variables not included in the model that could contribute further to the variation in the dependent variable.

Table 6 Moderating-test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.517186	0.089855	16.88489	0.0000
ESG	-0.012811	0.002027	-6.320654	0.0000
CS	0.012648	0.120894	0.104620	0.9167
ESG_CS	0.001107	0.002719	0.407036	0.6842
ROA	1.881676	0.280132	6.717113	0.0000

The regression analysis results show that the ESG variable has a negative coefficient of -0.012811 with a t-statistic of -6.320654 and a probability of 0.0000, indicating that the effect of ESG on the dependent variable is statistically significant. This means that an increase in the ESG score is associated with a decrease in the dependent variable. The CS variable shows a positive coefficient of 0.012648, but with a low t-statistic (0.104620) and a probability of 0.9167, indicating that its effect is not significant. The ESG_CS interaction variable has a coefficient of 0.001107, with a t-statistic of 0.407036 and a probability of 0.6842, also showing no significant effect. Finally, the ROA variable has a positive coefficient of 1.881676, a t-statistic of 6.717113, and a probability of 0.0000, indicating that ROA has a significant and positive effect on the dependent variable. Overall, these results suggest that ESG and ROA significantly contribute to the model, while CS and the ESG_CS interaction do not have a meaningful impact.

Discussion

Research shows a significant negative relationship between Environmental, Social, and Governance (ESG) performance and firm value, contradicting previous studies that highlighted a positive impact (Melinda & Wardhani, 2020; Vicente et al., 2021; El-Deeb et al., 2023; Duan et al., 2023; Ruth et al., 2023) The findings suggest that ESG performance, particularly in the short term, can reduce profitability due to high implementation costs, lack of market awareness, and regulatory challenges in Indonesia. Despite the long-term potential of ESG investments in enhancing operational efficiency and reducing financial risks, their immediate financial burden often leads investors to undervalue these efforts.

The stakeholder theory (Rastogi et al., 2024; Freeman & Phillips, 2002) is relevant here, emphasizing the need for companies to communicate ESG benefits effectively to gain stakeholder support. The lack of such communication may lead to skepticism about ESG initiatives, particularly in markets like Indonesia where regulatory frameworks and infrastructure are still developing.

Regarding the environmental pillar of ESG, the results show a significant negative impact on firm value. Despite the potential long-term benefits of green investments, high initial costs and operational adjustments often burden companies financially in the short run. This finding aligns with stakeholder and legitimacy theories, indicating that while ESG practices may improve reputation, their financial returns may not be immediate.

In contrast, the social pillar of ESG showed no significant impact on firm value. However, a holistic ESG strategy that integrates social, environmental, and governance factors may still enhance long-term firm value by building stakeholder trust, as seen in other studies (Vicente et al., 2021).

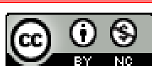
The governance pillar also showed a negative relationship with firm value, suggesting that stringent governance measures can increase operational costs and reduce flexibility, potentially signaling internal issues to investors. This contradicts previous studies (Melinda & Wardhani, 2020; Vicente et al., 2021), which found a positive link between governance and firm value.

The analysis also showed that capital structure does not have a significant moderating effect on the relationship between ESG and firm value. This finding is attributed to the lack of ESG integration in corporate strategies in Indonesia, where investors tend to prioritize short-term financial performance over sustainability. This finding appears to contradict previous studies that highlight the important role of capital structure as a moderator, such as Wahyuni's (2018) research, which identified capital structure as a moderator in the relationship between corporate governance and firm value. This is consistent with agency theory (Jensen & Meckling, 1976), which states that capital structure can act as a control mechanism to manage the relationship between owners (principals) and management (agents). This seems to differ from the findings of this study.

Finally, Return on Assets (ROA) showed a significant positive impact on firm value, reinforcing the importance of operational efficiency. Improving ROA is a key strategy for enhancing firm value, as it reflects effective asset management and attracts positive market assessment.

Conclusion

Based on the findings explained in the previous research results and discussion regarding the effect of environmental, social, and governance (ESG) performance on firm value with capital structure as a moderating variable in non-financial sector companies listed on the Indonesia Stock Exchange during the period of 2014–2023, the following conclusions can be drawn:



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The research results show a significant negative effect of ESG performance on firm value, which contradicts some previous findings that suggest ESG has a positive impact on firm value. The explanation for this result can be found in the context of ESG implementation and recognition in Indonesia, which still faces various challenges. High initial costs for sustainability initiatives and the lack of market awareness of the long-term value of ESG practices may lead to a negative impact on firm value in the short term.

The environmental (Environmental) variable has a significant negative effect on firm value. Although this finding seems to contradict previous research that revealed a positive contribution of ESG scores to firm value, it highlights the complexity of the relationship between environmental aspects and financial performance. The high implementation costs of environmentally friendly practices, which have not yet delivered direct financial impacts, could be a contributing factor to this negative effect in the short term.

The social variable has no significant effect on firm value. However, this does not imply that social aspects in the Environmental, Social, and Governance (ESG) framework are unimportant. Although the social variable did not show significance in this analysis, previous studies have emphasized that the impact of social performance often interacts with other aspects, such as environmental and governance factors, in enhancing firm value.

The governance (governance) variable has a significant negative effect on firm value, indicating that an increase in governance quality is actually associated with a decrease in firm value. This phenomenon could be caused by several factors, such as additional costs for governance compliance, market perceptions of potential risks, or industry and regional conditions specific to the research subject.

Capital structure (CS) does not have a significant effect on firm value (Tobin's Q) and does not act as a moderator in the relationship between ESG and firm value. This suggests that capital structure does not influence the relationship between ESG and firm value, either directly or through interaction.

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