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## The Impact of Greenwashing Practices on Stock Liquidity and Volatility in Indonesia

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### **ABSTRACT**

This study examines the impact of greenwashing on stock liquidity and volatility, using data from companies listed on the Indonesian stock exchange in the period 2018 to 2022. The results show that greenwashing has a positive impact on liquidity. The results show that greenwashing has a positive effect with stock price volatility, which indicates that increased greenwashing leads to higher market uncertainty. Furthermore, greenwashing has a negative effect on liquidity during the Covid-19 pandemic, but the effect of greenwashing on stock volatility is not different during the Covid-19 period.

**Keywords** - Greenwashing, Liquidity, Volatility

### **1. INTRODUCTION**

Climate change and environmental degradation have driven a global transition to a more sustainable green economy, with companies increasingly required to play a role in addressing these issues. However, in an effort to meet the demands of consumers, investors and market competition, some companies perceived to have a negative impact on the environment resort to greenwashing practices, i.e. misleading eco-friendly product claims to create a "green" image without delivering on those promises. While greenwashing may improve brand image, it risks negatively impacting a company's financial performance in the long run. Past research shows that dishonest greenwashing claims can trigger consumer rejection and reduce trust in companies, which in turn

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affects their financial performance (Schmuck et al., 2018). In addition, research by Wu & Shen, (2013) found that Corporate Social Responsibility (CSR) has a positive correlation with financial performance in the banking sector, but this is not the case for institutions that engage in greenwashing. The practice of greenwashing also increases information imbalances in the stock market, which makes it difficult for investors to assess the environmental and financial risks of companies. This potentially impacts stock liquidity and volatility, which are important characteristics in investment risk assessment. Although the impact of greenwashing on financial performance is widely discussed in international literature, research on its effect on stock liquidity and volatility in Indonesia is still limited, so this study aims to further examine the impact of greenwashing on stock market stability in Indonesia.

## **2. LITERATURE REVIEW**

### **2.1. Greenwashing**

Greenwashing is the phenomenon of misleading communication regarding the environmental performance or benefits of an organization, product, or service. Tateishi, (2018) reveals that greenwashing involves the disclosure of concealed negative information and the dissemination of misleading positive information related to the environmental performance of a company. This phenomenon is often done through selective disclosure, where companies only display positive information about their environmental performance, while the negative information is hidden. Lyon & Maxwell, (2011) define selective disclosure as a form of greenwashing, where companies disclose positive information without disclosing relevant negative information. Marquis et al., (2011) adds that selective disclosure is a symbolic strategy that companies use to gain or maintain legitimacy by accentuating favorable performance indicators, while obscuring poorer performance.

Greenwashing is also associated with decoupling behavior or separation between declarations and real actions (Siano et al., 2017). Companies that engage in greenwashing often use symbolic actions to meet stakeholder demands related to sustainability without any real changes in their practices. Delmas & Burbano, (2011) define greenwashing as misleading actions that aim to deceive consumers about an organization's environmental practices or the environmental benefits of the products or services offered. The two main forms of greenwashing are claim greenwashing and executional greenwashing. Parguel et al., (2015) introduced the concept of executional greenwashing, which does not rely on textual claims of ecological benefits, but uses visual or sensory elements such as images of nature, green colors, or natural sounds (e.g. ocean or bird sounds) to create a misleading eco-friendly image.

### **2.2. Greenwashing and Stock Liquidity**

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Greenwashing has a significant impact on stock liquidity, particularly in relation to the ease of buying and selling shares in the market at stable and reasonable prices. This practice creates information asymmetry between companies and investors, where companies often make misleading or inaccurate claims regarding their environmental practices, which in turn leads to mispricing in the market (Stambaugh & Yuan, 2017) . Information asymmetry in the context of greenwashing occurs when companies or bond issuers have more information about the environmental impact of their products or services compared to investors or buyers (Schmittmann & Gao, 2022) . This imbalance allows companies to claim exaggerated or false environmental benefits in the absence of an easy verification mechanism for buyers. As investors become more aware of the potential for greenwashing, they are likely to demand more accurate and transparent information, which may increase costs for companies and reduce stock market liquidity.

As a result, greenwashing may contribute to less efficient markets and decrease capital flows to firms that are truly environmentally responsible. The information asymmetry generated by this practice plays a key role in determining the market liquidity of a company's stock, where companies with poor disclosure and less transparency will experience lower levels of liquidity (Diamond & Verrecchia, 1991; Kurlat, 2018). In addition, greenwashing practices may reduce investor confidence, leading to a decrease in stock trading activity. Recent research shows that greenwashing can reduce the liquidity of a company's shares as investors tend to be reluctant to transact with companies that are considered non-transparent (Bo et al., 2025) .

## **H1 : Greenwashing negatively affects the liquidity of company shares**

### **2.3. Greenwashing and Stock Price Volatility**

In line with information asymmetry theory, research by Xu & Liu, (2018) shows that transparent Corporate Social Responsibility (CSR) disclosures can reduce stock price volatility and changes in consumer behavior following such disclosures. The rationale behind this is that by providing stakeholders with more in-depth and accurate information on corporate environmental disclosures, the level of information asymmetry is reduced, which in turn increases trust and lowers stock price volatility. However, in the case of greenwashing, where the gap between a company's actual investment in CSR and its public disclosure is greater, information asymmetry increases. Research by Yu et al., (2018) and Bo et al., (2025) show that smaller disclosure gaps related to ESG can reduce idiosyncratic risk and information asymmetry, which facilitates capital attractiveness and has a positive impact on the company's market value. Such reduced risk and increased capital attractiveness ultimately contribute to higher stock liquidity and lower stock price volatility.

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In contrast, Watson et al., (2002) argue that by demonstrating the value of more disclosure, firms can reduce capital expenditure and uncertainty. Companies that are more transparent in their CSR practices tend to gain a positive reputation, which attracts investors. However, in situations where greenwashing occurs, companies that do not act responsibly may cause investors to withdraw their funds and penalize such companies, potentially increasing stock price volatility. Thus, we hypothesize that

**H2 : Greenwashing has a positive effect on stock price volatility.**

### **3. Empirical Data and Model**

#### **3.1. Data & Variable Measurement**

The period analyzed in this study is from 2018 to 2022. The secondary data used was obtained from S&P Capital IQ and the Investing website. This study involves three variables, namely dependent variables, independent variables, and control variables. The dependent variables studied are the liquidity and volatility of the company's shares.

The independent variable, Greenwashing is calculated from a score that reflects the significant gap between ESG disclosures and the company's actual ESG performance. Freshtriana & Kim (2025) formulated the Greenwashing calculation as follows:

$$\text{Greenwashing Score } i, t = \left( \frac{ESGdis, i, t - ESGdis}{\sigma dis} \right) - \left( \frac{ESGreal, i, t - ESGreal}{\sigma real} \right)$$

$ESGdis, i, t$  is the ESG disclosure score of company  $i$  in year  $t$ , while  $ESGreal, i, t$  is the actual ESG performance score for the same company. In this calculation,  $ESGdis$  includes the average ESG disclosure score of all companies, and  $ESGreal$  is the average actual ESG performance score of all companies. In addition,  $\sigma dis$  and  $\sigma real$  are the standard deviations of the two scores, with  $\sigma dis$  representing the standard deviation of the ESG disclosure score and  $\sigma real$  representing the standard deviation of the actual ESG performance score.

The first dependent variable, stock liquidity is calculated using the Amihud Illiquidity measure. This research contributes to a deeper understanding of the Amihud liquidity measure (Amihud, 2002) , which is widely used in the financial literature. The Amihud measure is shown to be effective in capturing stock illiquidity and price impact, as it has a strong correlation with high frequency price impact benchmarks. Amihud measures stock illiquidity by taking into

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account daily returns and daily dollar trading volume, where higher trading volume tends to lower the illiquidity measure. This relationship is very strong, as the variation in trading volume is greater than the variation in stock returns. A higher Amihud ratio indicates lower liquidity, as illiquid stocks are more sensitive to trading. The Amihud measure has also proven to be one of the best benchmarks to evaluate the market price impact of stocks. The Amihud ratio is formulated with:

$$A_{iy} = \frac{1}{Diy} \sum_{t=1}^{Diy} \frac{[rit]}{Dvol it}$$

The second dependent variable studied is stock price volatility. Standard deviation, which measures the spread of data from the mean, is an effective way to examine stock price volatility in relation to greenwashing. Standard deviation can be used to evaluate stock price movements over time. If a stock has a high standard deviation, it is likely to experience significant price fluctuations, making its share price more difficult to predict, indicating higher risk for investors. Conversely, stocks with low standard deviations tend to have smaller and more predictable price fluctuations, indicating lower risk. Therefore, standard deviation can be a useful tool for investors to assess the potential impact of greenwashing on a company's share price volatility.

In addition, other control variables in this study that affect firm value are Greencovid, Leverage, Firm Size (company size), ROA (Return of Asset), and DivYield (Dividend Yield).

This study uses a panel data regression method with fixed effects to examine the effect of Greenwashing on firm volatility and liquidity. The fixed effects approach is chosen to control for individual heterogeneity between firms that cannot be observed but is considered constant over time. Heterogeneity refers to differences in characteristics between firms that may affect the results of the analysis, whether observable or not. In the context of panel data, the fixed effects approach is used to control for unobserved individual heterogeneity that is considered constant over time, such as organizational culture, leadership style, or corporate reputation. By eliminating these fixed effects, the fixed effects model allows the estimation of the relationship between variables to be more accurate and free from bias due to factors that are not directly measured. The model is also equipped with the Driscoll-Kraay standard error correction, which is able to handle autocorrelation, heteroscedasticity, and cross-sectional dependence that often appear in panel data with a short time dimension but a large number of entities. The hypothesized model to explore the effect of greenwashing on liquidity and volatility is as follows:

Model 1: Without greencovid

$$Y_{it} = \beta^0 + \beta^1 Greenwashing_{it} + \beta^2 Leverage_{it} + \beta^3 FirmSize_{it} + \beta^4 ROA_{it} + \beta^5 DivYield_{it} + \alpha_i + \varepsilon_{it}$$

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Model 2: With greencovid

$$Y_{it} = \beta^0 + \beta^1 Greenwashing_{it} + \beta^2 Greencovid_{it} + \beta^3 Leverage_{it} + \beta^4 FirmSize_{it} + \beta^5 ROA_{it} + \beta^6 DivYield_{it} + \alpha_i + \varepsilon_{it}$$

Where Y is liquidity or volatility as the dependent variable, respectively. The independent variable is greenwashing, which refers to the significant gap between ESG disclosures and the company's actual ESG performance. The control variables in this study include greenwashing measured by liquidity and volatility during the Covid pandemic period, firm size measured by the natural logarithm of total employees (Size), Leverage measured by the ratio of debt to total assets (LEV), ROA indicated by the ratio of net income to total assets, and Dividend Yield measured by dividing dividends per share by stock price. Through regression analysis in this study, it can be identified whether there is a significant relationship between greenwashing behavior and the liquidity and volatility of company shares.

## 4. Empirical Results

### 4.1. Descriptive statistic

The number of companies used in this study is 60 companies, with a total of 300 observations for 5 years from 2018 to 2022. However, not all 60 companies have greenwashing data for all 5 years. Therefore, the total number of observations is 271.

**Table 1. Descriptive Statistics**

Variable	Obs	Mean	Std. dev.	Min	Max
Greenwashing	271	-0.040002	1.199425	-2.50348	4.522368
Volatility	271	0.061682	0.03181	0.018487	0.260739
Liquidity	271	0.56116	3.988267	0.00001	44.780528
Leverage	271	0.221261	0.216919	0.0003	1.666285
FirmSize	271	12.251508	3.09435	5.4858	16.32832
ROA	271	4.02175	5.590429	-29.669	45.934
DivYield	271	2.498523	3.402335	0.0479	30.8685

Descriptive statistics in this study provide an initial description of the characteristics of each variable. The average greenwashing value was recorded at -0.040 with a standard deviation

of 1.199, indicating a diversity in the level of greenwashing practices between companies, from very low (minimum -2.503) to very high (maximum 4.522). Stock volatility has an average value of 0.061 with a standard deviation of 0.032, reflecting a relatively moderate level of stock price fluctuations in the sample population. Meanwhile, the level of liquidity shows significant disparity, with an average of 0.561 and a standard deviation of 3.988, as well as a very wide range of values (0.00001 to 44.781), indicating that there are companies with very actively traded shares and some are very illiquid. The leverage variable shows an average of 0.221, with a minimum value of 0.00003 and a maximum of 1.666, reflecting the diversity of the company's capital structure in terms of debt usage. The FirmSize variable measured based on the logarithm of total assets has an average of 12.251 and a standard deviation of 3.094, with a range of values from 5.486 to 16.328, which indicates that the sample includes companies with a wide scale of assets, from small companies to large companies. This finding indicates that the data used in the study has a high degree of heterogeneity, thus providing a strong foundation for further regression analysis.

### 4.2. Effect of Greenwashing and Liquidity

The results of fixed effects regression analysis with Driscoll-Kraay standard error correction between greenwashing and liquidity are presented in table 2.

**Table 2. Greenwashing Regression Results on Liquidity**

	(1)	(2)	(3)	(4)
Greenwashing	0.0715 (0.0411)	0.1359** (0.0454)	-0.1634* (0.0752)	-0.2665* (0.1015)
Greencovid			0.3307** (0.0910)	0.5764*** (0.1119)
Leverage		1.0879* (0.4086)		1.5194** (0.4128)
FirmSize		-0.0262 (0.0516)		-0.0432 (0.0486)
ROA			-0.1505*** (0.0244)	-0.1629*** (0.0268)
DivYield			-0.0884 (0.0596)	-0.0700 (0.0593)
Constant	0.5640*** (0.0890)	1.4726* (0.6513)	0.5605*** (0.0887)	1.5844* (0.5995)
Observations	271	271	271	271
Prob > F	0.1568	0.1414	0.0527	0.0032
F-stat	3.03	3.2	6.71	27.64

*Note: Standard errors are in parentheses. \*\*\* p<0.01, \*\* p<0.05, \* p<0.1*

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The fixed effects regression results with Driscoll-Kraay standard error correction show that in the initial model (without control variables), greenwashing has a positive influence on the liquidity of company shares with a coefficient of 0.071, but the effect is not statistically significant ( $p = 0.157$ ). This suggests that in general, greenwashing practices are not strong enough to influence the ease of buying and selling shares in the market. However, after including control variables such as leverage, FirmSize, Return on Assets (ROA), and dividend yield, the effect of greenwashing becomes positive and significant (coefficient = 0.136;  $p = 0.040$ ). This finding suggests that after controlling for firm fundamentals, greenwashing practices are associated with an increase in stock liquidity, which may be due to investors' perception of corporate sustainability signals, albeit manipulative ones. In addition, ROA has a significant negative effect on liquidity ( $p = 0.004$ ), suggesting that more profitable companies have lower stock liquidity, possibly because investors prefer to hold shares of healthy companies. Meanwhile, leverage approaches positive significance ( $p = 0.056$ ), while firm size and dividend yield show no significant effect.

These results suggest that the effect of greenwashing on stock liquidity is contextual. In the initial model without control variables, greenwashing practices showed no significant effect on stock liquidity ( $p = 0.157$ ), although the direction of the coefficient was positive. This finding is in line with (Hallin et al., 2011) which states that trading volume alone is not sufficient to explain liquidity conditions without considering the information dimension and market perception. In the model with the addition of control variables such as Leverage, company size, ROA, and Dividend Yield, greenwashing shows a positive and significant effect on stock liquidity ( $p = 0.040$ ). This finding seems to contradict the information asymmetry theory proposed by Stambaugh & Yuan, (2017) and Schmittmann & Gao, (2022) , which emphasizes that greenwashing should decrease market efficiency due to information imbalance between companies and investors. However, this condition can be explained through the concept of executional greenwashing (Parguel et al., 2015) , where companies utilize visual and symbolic elements such as green colors, nature images, or natural sounds in marketing communications to create positive environmental perceptions, even though they do not reflect actual performance. In the context of the Indonesian market, this strategy seems to be quite successful as most domestic investors do not yet fully understand ESG in depth, and the sustainability audit or verification system in Indonesia is still not well established. As a result, market perceptions are more influenced by symbolically constructed green images rather than factual ESG data-based assessments.

The next model tested is by adding the greencovid variable to see the effect of greenwashing on liquidity. The results of fixed effects regression with Driscoll-Kraay correction during the Covid-19 pandemic period show that greenwashing has a negative influence on the liquidity of company shares. In the model without additional control variables, the greenwashing coefficient is -0.163 with a p-value of 0.096, indicating a negative effect that is close to statistically significant. Meanwhile, the greencovid variable, which reflects the intensity of sustainability disclosures related to Covid-19, shows a significant positive effect on liquidity (coefficient = 0.331;  $p = 0.022$ ), indicating that companies that actively communicate sustainability responses during the pandemic tend to have more liquid shares. When control variables are added to the

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model, the negative effect of greenwashing becomes stronger and more significant (coefficient = -0.266;  $p = 0.058$ ), emphasizing that the market responds negatively to greenwashing practices during times of crisis. In contrast, the effect of greencovid increases to be highly significant (coefficient = 0.576;  $p = 0.007$ ), suggesting that contextually relevant sustainability transparency, in this case the pandemic, is valued by the market. These results indicate that during crisis periods, investors become more selective and respond more critically to sustainability signals, so greenwashing practices adversely affect the liquidity of company shares.

From these results, it can be seen that during the COVID-19 pandemic, the interaction results between greenwashing and greencovid show that greencovid actually has a positive and significant effect on stock liquidity ( $p = 0.007$ ). This suggests that in a crisis situation, investors tend to be more receptive to positive narratives shaped by companies, even if these narratives are not entirely accurate or action-based. In this context, greenwashing serves as a symbolic legitimization mechanism (Marquis et al., 2011) and a form of decoupling behavior (Siano et al., 2017), where companies maintain market trust through symbolic communication that is not accompanied by substantive changes. This also suggests that under stressful conditions such as a pandemic, market perceptions are more easily influenced by communication strategies than by critical evaluation of sustainability fundamentals. Thus, while greenwashing is theoretically expected to reduce liquidity by lowering investor confidence, these findings suggest that in the context of developing countries such as Indonesia, where ESG literacy is still limited and market mechanisms are not yet fully efficient, greenwashing can actually strengthen market perceptions and increase liquidity, especially in the short term and in emergency situations such as a pandemic.

Overall, the results of this study suggest that the effect of greenwashing on liquidity is highly dependent on the external context. While greenwashing can generally have a negative impact, in crisis situations such as the COVID-19 pandemic, this practice can actually have a positive impact on company liquidity.

### **4.3. Effect of Greenwashing and Volatility**

The results of fixed effects regression analysis with Driscoll-Kraay standard error correction between greenwashing and liquidity are presented in table 3.

**Table 3. Regression Results of Greenwashing on Volatility**

	(1)	(2)	(3)	(4)
	0.0019**	0.0021***	0.0010	0.0010
Greenwashing	(0.0005)	(0.0004)	(0.0005)	(0.0007)

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		0.0012	0.0017
Greencovid		(0.0012)	(0.0012)
	0.0262**		0.0274**
Leverage	(0.0075)		(0.0068)
	0.0007		0.0007
FirmSize	(0.0013)		(0.0013)
	-0.0003		-0.0003
ROA	(0.0004)		(0.0004)
	-0.0010*		-0.0009*
DivYield	(0.0004)		(0.0004)
	0.0618***	0.0507**	0.0617***
cons	(0.0049)	(0.0115)	(0.0049)
			(0.0116)
Observations	271	271	271
Prob > F	0.0153	0.0408	0.0012
F-stat	16.53	7.06	56.48
			160.58

*Note: Standard errors are in parentheses. \*\*\* p<0.01, \*\* p<0.05, \* p<0.1*

The results of fixed effects regression with Driscoll-Kraay correction under normal conditions show that greenwashing practices have a positive and significant influence on the volatility of company shares. In the initial model without control variables, greenwashing shows a coefficient of 0.0019 with a significance level of  $p = 0.015$ , which means that the higher the intensity of greenwashing, the greater the stock price fluctuations that occur. This indicates that the market responds to greenwashing practices with uncertainty, which is reflected in increased volatility. When control variables such as leverage, FirmSize, ROA, and dividend yield are included in the second model, the effect of greenwashing on volatility actually strengthens (coefficient = 0.0021;  $p = 0.007$ ), showing the consistency of the positive relationship.

These results indicate that greenwashing has a positive and significant effect on stock price volatility under normal conditions ( $p = 0.015$  in the initial model,  $p = 0.007$  in the model with control variables). This finding is consistent with signaling theory (Spence, 1973), which states that non-credible signals, such as ESG disclosures that do not reflect real performance, increase investor uncertainty and doubt, thus triggering higher stock price fluctuations. The Indonesian market context reinforces this phenomenon, given that most ESG disclosures in Indonesia are still self-reported and have not been verified by independent institutions. Moreover, this uncertainty is further exacerbated by investors' sensitivity to news, public sentiment, and changing perceptions of corporate reputation. Companies known to be greenwashing, when exposed by the media or civil society organizations, have the potential to experience significant selling pressure, leading to increased stock price volatility. Overall, these results support the assumption that greenwashing,

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as a form of misleading information signaling, increases investor uncertainty over the real value of the company, resulting in increased stock volatility.

The next model tested is by adding the greencovid variable to see the effect of greenwashing on volatility. The fixed effects regression results with Driscoll-Kraay correction during the Covid-19 pandemic period show that the effect of greenwashing on stock volatility tends to weaken and is not statistically significant. In the initial model that only includes greenwashing and greencovid, greenwashing shows a positive coefficient of 0.00105 with a p-value of 0.127, while greencovid has a coefficient of 0.00119 but is not significant ( $p = 0.370$ ). This indicates that during the crisis, neither greenwashing practices nor sustainability communication related to Covid directly triggered meaningful stock price fluctuations. When control variables are included in the second model, the coefficient of greenwashing decreases to 0.00099 ( $p = 0.204$ ) and greencovid to 0.00165 ( $p = 0.228$ ), remaining insignificant.

These results suggest that in a crisis situation, investors' focus shifts from symbolic narratives to fundamental indicators such as leverage, solvency, and the company's survival ability. This finding is in line with the views of Watson et al., (2002) and Xu & Liu, (2018) , which emphasize that under conditions of high uncertainty, credible sustainability disclosures will be rewarded by the market, but symbolic signals without real basis will be ignored as investors prioritize financial and operational aspects. In this context, capital structure proves to be the dominant factor influencing stock volatility, while greenwashing loses its relevance as a driver of market sentiment. Overall, these findings indicate that while greenwashing practices may increase stock volatility under normal conditions, the effect is not significant in the context of the COVID-19 pandemic. Overall, these results suggest that during the pandemic, the market does not respond to greenwashing practices or Covid ESG communication in an extreme manner, and stock volatility is more influenced by fundamental factors such as leverage and dividend policy.

## 5. CONCLUSIONS

The findings make an important contribution to the ESG and financial market literature, particularly in understanding the dynamics of greenwashing in emerging economies. Theoretically, the results confirm that the effect of greenwashing is not linear, but highly dependent on external conditions such as global crisis and market structure. Greenwashing practices, which in information asymmetry theory are considered to reduce market efficiency, may in practice increase liquidity in less mature markets as investors are more influenced by symbolic narratives than substantial analysis. This finding also corroborates the concept of greenwashing as part of selective disclosure and symbolic management strategies (Delmas & Burbano, 2011) ,

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which shows that companies not only use greenwashing to build a green image, but also to adaptively respond to market expectations, especially in emergency conditions.

Practically, these findings provide a warning to companies that greenwashing strategies, while capable of creating short-term benefits in the form of increased liquidity, can have long-term consequences in the form of increased stock price volatility and loss of investor confidence. For investors, these results point to the importance of improving ESG literacy and conducting thorough due diligence on companies' sustainability performance, not just based on visual imagery or CSR rhetoric. Meanwhile, for regulators such as OJK and the Indonesia Stock Exchange, strengthening a standardized and transparent ESG reporting system is needed, as well as increasing the capacity of domestic ESG assessment institutions to provide credible and reliable assessments. In the long run, the successful integration of ESG in Indonesia's capital market depends largely on the collaboration between companies, investors, regulators, and supervisory agencies to create an accountable and effective sustainability ecosystem to drive stable and responsible market performance.

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