

## THE EFFECT OF ESG PERFORMANCE ON FIRM VALUE: EVIDENCE FROM INDONESIA AND MALAYSIA (2021–2024)

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### ABSTRACT

This study examines the impact of Environmental, Social, and Governance (ESG) performance on firm value in non-financial companies listed in Indonesia and Malaysia during the period 2021–2024. Although ESG has gained substantial global attention, empirical evidence regarding its effect on firm value remains inconclusive, particularly in emerging markets. Using panel data regression analysis on 364 firm-year observations, this research investigates the individual impact of environmental, social, and governance performance on Tobin’s Q as a proxy for firm value. ESG data are obtained from Refinitiv Eikon, while financial data are collected from annual reports and market databases. The findings reveal that governance performance significantly and positively influences firm value, supporting Signal Theory and suggesting that investors in emerging markets prioritize transparency and accountability. However, environmental and social performance show no statistically significant impact. The results indicate that ESG relevance is context-dependent and that governance mechanisms remain the most critical ESG pillar in Southeast Asian capital markets. This study contributes to the sustainability accounting literature by providing updated comparative evidence from two emerging economies and offering practical implications for corporate managers and policymakers.

**Keywords:** Environmental, Social, Governance (ESG); Firm Value; Tobin’s Q; Corporate Governance; Emerging Markets; Panel Data Regression.

### ABSTRAK

Studi ini meneliti dampak kinerja Lingkungan, Sosial, dan Tata Kelola (ESG) terhadap nilai perusahaan pada perusahaan non-keuangan yang terdaftar di Indonesia dan Malaysia selama periode 2021–2024. Meskipun ESG telah mendapatkan perhatian global yang substansial, bukti empiris mengenai pengaruhnya terhadap nilai perusahaan masih belum meyakinkan, khususnya di pasar negara berkembang. Dengan menggunakan analisis regresi data panel pada 364 observasi perusahaan-tahun, penelitian ini menyelidiki dampak individual kinerja lingkungan, sosial, dan tata kelola terhadap Tobin’s Q sebagai proksi untuk nilai perusahaan. Data ESG diperoleh dari Refinitiv Eikon, sedangkan data keuangan dikumpulkan dari laporan tahunan dan basis data pasar. Temuan menunjukkan bahwa kinerja tata kelola secara signifikan dan positif memengaruhi nilai perusahaan, mendukung Teori Sinyal dan menunjukkan bahwa investor di pasar negara berkembang memprioritaskan transparansi dan akuntabilitas. Namun, kinerja lingkungan dan sosial tidak menunjukkan dampak yang signifikan secara statistik. Hasil menunjukkan bahwa relevansi ESG bergantung pada konteks dan bahwa mekanisme tata kelola tetap menjadi pilar ESG yang paling penting di pasar modal Asia Tenggara. Studi ini berkontribusi pada literatur akuntansi keberlanjutan dengan memberikan bukti komparatif terkini dari dua negara berkembang dan menawarkan implikasi praktis bagi para manajer perusahaan dan pembuat kebijakan.

**Keywords:** Environmental, Social, Governance (ESG); Firm Value; Tobin’s Q; Corporate Governance; Emerging Markets; Panel Data Regression.

### 1. Introduction

Over the last decade, Environmental, Social, and Governance (ESG) considerations have shifted from being peripheral corporate initiatives to becoming central components of capital market evaluation. Globally, institutional investors increasingly incorporate ESG

metrics into portfolio allocation decisions, reflecting the belief that sustainability performance represents not merely ethical responsibility but also financial materiality. The rapid growth of sustainable investment assets worldwide demonstrates that ESG has evolved into a mainstream investment paradigm.

However, despite the global momentum of ESG integration, its economic consequences remain empirically contested, particularly in emerging markets. While numerous studies in developed economies document a positive relationship between ESG performance and firm value, evidence from emerging markets shows mixed and inconclusive results. This divergence suggests that ESG relevance may be contingent upon institutional environments, regulatory enforcement, investor sophistication, and corporate governance maturity.

Indonesia and Malaysia provide a compelling research context due to their distinct but comparable institutional characteristics. Malaysia has implemented relatively structured sustainability reporting requirements and strengthened corporate governance enforcement under Bursa Malaysia’s listing framework. Conversely, Indonesia has made regulatory progress through OJK sustainability mandates; however, ESG disclosure quality and enforcement remain uneven across sectors. These differences raise an important empirical question: does ESG performance enhance firm value consistently across these two emerging Southeast Asian economies?

The phenomenon gap becomes evident when comparing regulatory ambition with market reaction. Regulators in both countries actively promote sustainability disclosure, yet market capitalization responses to ESG improvements appear limited and inconsistent. In some cases, firms with high ESG scores do not necessarily exhibit higher valuation multiples, suggesting potential misalignment between regulatory expectations and investor behavior.

Furthermore, prior empirical research presents conflicting findings. Some studies argue that ESG enhances firm value by reducing information asymmetry, improving stakeholder trust, and mitigating long-term risks. Other studies suggest that ESG investments impose additional operational costs that may not yield immediate financial returns, particularly in markets where investor awareness remains developing. These inconsistencies indicate the presence of an unresolved research gap regarding the financial materiality of ESG in emerging markets.

Another limitation in previous research lies in the treatment of ESG as a single composite index. Aggregating environmental, social, and governance dimensions may obscure the heterogeneous effects of each pillar. Governance mechanisms, for instance, directly address agency conflicts and transparency concerns, while environmental and social initiatives may generate benefits that materialize over a longer horizon. Disaggregating ESG into its individual components provides a more nuanced understanding of which dimension investors prioritize.

This study therefore seeks to address three primary research gaps: 1. The limited comparative evidence between Indonesia and Malaysia. 2. The lack of disaggregated analysis of ESG pillars. 3. The need for updated post-pandemic empirical data (2021–2024).

The dependent variable in this study is firm value, proxied by Tobin’s Q, which captures market perception of future growth opportunities relative to asset replacement cost. The independent variables consist of environmental, social, and governance performance scores. The theoretical relationship between these variables is grounded in Stakeholder Theory, Agency Theory, and Signal Theory, which collectively explain how ESG performance may influence investor perception and valuation. By examining the partial effect of each ESG pillar on firm value, this study contributes to the ongoing debate

regarding whether sustainability performance is financially material in emerging Southeast Asian capital markets.

## **2. Literature Review**

### **2.1 Stakeholder Theory**

Stakeholder Theory, originally articulated by Freeman (1984), posits that firms operate within a network of relationships involving multiple stakeholder groups, including shareholders, employees, customers, suppliers, regulators, and local communities. The theory challenges the traditional shareholder primacy perspective by arguing that long-term corporate success depends on the firm's ability to balance and satisfy diverse stakeholder interests.

In the context of ESG performance, Stakeholder Theory provides a foundational explanation for why environmental, social, and governance practices may enhance firm value. Environmental responsibility reduces negative externalities that could provoke regulatory sanctions or community opposition. Social engagement fosters employee loyalty, customer trust, and brand reputation. Governance mechanisms ensure fairness, transparency, and accountability in decision-making processes.

From a valuation perspective, effective stakeholder management reduces operational risk and enhances long-term sustainability. Firms that neglect stakeholder expectations may face litigation, reputational damage, or consumer boycotts, ultimately eroding firm value. Conversely, firms that proactively address environmental and social concerns may secure stakeholder support, leading to improved financial performance and market valuation.

However, the strength of this relationship may vary across institutional contexts. In emerging markets, stakeholder activism may be less intense, and enforcement mechanisms may be weaker. Consequently, the financial materiality of stakeholder-oriented ESG practices may differ from developed markets.

### **2.2 Signal Theory**

Signal Theory, developed by Spence (1973), explains how information asymmetry between two parties can be mitigated through credible signaling mechanisms. In capital markets, managers possess private information about firm quality and future prospects, while investors rely on observable indicators to assess firm value. ESG performance functions as a strategic signal of corporate quality. High ESG scores may indicate superior risk management systems, ethical leadership, and long-term strategic orientation. By voluntarily disclosing ESG information, firms signal transparency and accountability, thereby reducing uncertainty among investors.

In emerging markets, information asymmetry tends to be higher due to weaker disclosure standards and less developed financial infrastructures. Under such conditions, governance-related ESG signals may be particularly valuable because they directly address concerns regarding opportunistic managerial behavior and agency conflicts. However, for a signal to be effective, it must be credible and costly to imitate. ESG initiatives often require substantial resource commitment, making them costly signals that differentiate high-quality firms from lower-quality counterparts. Therefore, Signal Theory predicts that firms with superior ESG performance should experience higher market valuation due to reduced information asymmetry and enhanced investor confidence.

## **2.3 Hypothesis Development**

### **2.3.1 Environmental Performance and Firm Value**

Environmental performance encompasses corporate initiatives aimed at reducing carbon emissions, improving energy efficiency, managing waste, and adopting sustainable resource practices. From a risk management perspective, strong environmental performance reduces exposure to regulatory penalties and environmental litigation.

Previous empirical studies in developed markets report a positive association between environmental performance and firm value, suggesting that investors reward firms that demonstrate proactive environmental responsibility. However, other studies find insignificant effects, arguing that environmental investments may increase short-term costs without immediate financial return.

In emerging markets, environmental regulation enforcement may be less stringent, and investor environmental awareness may be evolving. Consequently, the market may not fully price environmental performance into firm valuation. Despite these contextual considerations, Stakeholder Theory suggests that proactive environmental management enhances legitimacy and long-term sustainability. Environmental initiatives require substantial investment in renewable energy, waste management, and carbon reduction. In developed markets, environmental responsibility may enhance valuation due to regulatory pressure and investor activism. However, in emerging markets, environmental awareness may be less internalized by investors. Therefore:

**H1 : Environmental performance positively affects firm value.**

### **2.3.2 Social Performance and Firm Value**

Social performance includes labor practices, diversity, community engagement, and product responsibility. Social capital may strengthen corporate reputation. Social performance reflects corporate practices related to employee welfare, diversity and inclusion, community engagement, product responsibility, and human rights protection. Strong social performance may improve employee productivity, customer loyalty, and brand equity.

Empirical evidence on social performance and firm value is mixed. Some studies document positive effects due to enhanced reputation and stakeholder trust. Others find limited or insignificant relationships, particularly in markets where social accountability is not strongly institutionalized. In emerging Southeast Asian markets, investor emphasis may prioritize profitability and governance stability over social initiatives. However, social capital can indirectly strengthen firm resilience during economic uncertainty. Therefore:

**H2: Social performance positively affects firm value.**

### **2.3.3 Governance Performance and Firm Value**

Governance directly addresses agency problems and transparency concerns. Investors in emerging markets may prioritize governance stability due to higher perceived risks. Governance performance represents the structural mechanisms that ensure managerial accountability, including board independence, audit committee effectiveness, shareholder rights, and anti-corruption policies.

Agency Theory strongly predicts a positive relationship between governance quality and firm value. Strong governance reduces agency costs, mitigates earnings manipulation, and enhances transparency. Numerous empirical studies consistently find governance to be the most financially material ESG pillar, particularly in emerging markets characterized by higher institutional risk. Given the direct impact of governance on investor protection and risk perception:

**H3: Governance performance positively affects firm value.**

### 3. Research Method

This study employs a quantitative explanatory research design using panel data regression analysis to examine the relationship between ESG performance and firm value. Panel data combines cross-sectional and time-series dimensions, enabling researchers to control for unobserved heterogeneity and improve estimation efficiency (Baltagi, 2005; Wooldridge, 2010). Compared to purely cross-sectional analysis, panel data provides more variability, less collinearity among variables, and greater degrees of freedom, thereby enhancing statistical power. The empirical strategy is designed to test the partial effect of environmental, social, and governance performance on firm value while controlling for firm-specific financial characteristics.

#### 3.1 Population and Sample Selection

The population consists of all non-financial companies listed on:

- Indonesia Stock Exchange (IDX)
- Bursa Malaysia

Financial firms are excluded due to differences in regulatory capital structure and reporting standards (Fama & French, 1992).

Sampling is conducted using purposive sampling with the following criteria:

1. Firms must be listed continuously from 2021–2024.
2. Firms must have complete ESG scores available in Refinitiv Eikon.
3. Firms must publish complete annual financial statements.

The final sample consists of 91 firms over four years, resulting in 364 firm-year observations.

#### 3.2 Variable Measurement and Operationalization

##### 3.2.1 Dependent Variable: Firm Value

Firm value is proxied using Tobin’s Q, which reflects market-based valuation and growth expectations. Tobin’s Q is widely used in corporate finance literature as a forward-looking measure of firm performance (Lindenberg & Ross, 1981).

The formula is:

$$TQ_{it} = \frac{MVE_{it} + DEBT_{it}}{TA_{it}}$$

Where:

- $TQ_{it}$  = Tobin’s Q of firm  $i$  at time  $t$
- $MVE_{it}$  = Market Value of Equity
- $DEBT_{it}$  = Total Debt
- $TA_{it}$  = Total Assets

Market Value of Equity is calculated as:

$$MVE_{it} = P_{it} \times Shares_{it}$$

Where:

- $P_{it}$  = closing stock price
- $Shares_{it}$  = outstanding shares

Tobin’s Q greater than 1 indicates that the market values the firm above its asset replacement cost, suggesting strong growth opportunities.

### 5.3 Independent Variables: ESG Performance

ESG performance is measured using Refinitiv ESG pillar scores, ranging from 0 to 100.

1. Environmental Score (ENV)
2. Social Score (SOC)
3. Governance Score (GOV)

The ESG composite score can be represented as:

$$ESG_{it} = \frac{ENV_{it} + SOC_{it} + GOV_{it}}{3}$$

However, in this study, ESG pillars are analyzed separately to capture heterogeneous effects.

### 3.4. Control Variables

To mitigate omitted variable bias (Gujarati & Porter, 2009), several control variables are included:

(1) Firm Size

$$SIZE_{it} = \ln(TA_{it})$$

Larger firms tend to have greater disclosure capacity and market visibility.

(2) Profitability (ROA)

$$ROA_{it} = \frac{Net\ Income_{it}}{Total\ Assets_{it}}$$

Profitability signals operational efficiency (Fama & French, 1998).

(3) Leverage

$$LEV_{it} = \frac{Total\ Debt_{it}}{Total\ Assets_{it}}$$

High leverage may increase financial risk and affect firm valuation.

(4) Growth

$$GROWTH_{it} = \frac{Sales_{it} - Sales_{it-1}}{Sales_{it-1}}$$

Growth opportunities are positively associated with firm value.

### 4.4 Econometric Model Specification

The baseline regression model is specified as follows:

$$TQ_{it} = \alpha + \beta_1 ENV_{it} + \beta_2 SOC_{it} + \beta_3 GOV_{it} + \beta_4 SIZE_{it} + \beta_5 ROA_{it} + \beta_6 LEV_{it} + \beta_7 GROWTH_{it} + \varepsilon_{it}$$

Where:

- $i$  = firm
- $t$  = year
- $\varepsilon_{it}$  = error term

## 4. Results and Discussion

### 4.1 Descriptive Statistics

Table 1 presents the descriptive statistics of the variables used in this study.

Variable	Mean	Median	Std. Dev	Min	Max
Tobin's Q	1.42	1.18	0.73	0.65	4.89
Environmental Score	54.10	52.30	14.22	21.50	86.40
Social Score	58.70	57.80	12.91	25.60	89.70
Governance Score	62.30	63.10	10.34	34.20	91.50
Firm Size (Ln TA)	28.11	27.95	1.43	24.80	31.90
ROA	0.083	0.072	0.061	-0.21	0.32
Leverage	0.44	0.42	0.19	0.08	0.81
Growth	0.11	0.09	0.24	-0.35	0.79

The average Tobin's Q of 1.42 indicates that, on average, the market values firms above their book value, suggesting the presence of growth opportunities. Governance scores exhibit the highest mean (62.30) and the lowest standard deviation among ESG pillars, indicating relatively stronger and more stable governance practices compared to environmental and social dimensions. Environmental performance displays the highest dispersion (Std. Dev = 14.22), suggesting uneven environmental engagement across firms. This variation may influence the statistical significance of environmental performance in regression analysis.

### 4.2 Model Selection Results

The Chow test rejects the pooled OLS model ( $p < 0.01$ ), indicating the presence of firm-specific effects. The Hausman test shows a significant result ( $p < 0.05$ ), suggesting that the Fixed Effect Model (FEM) is more appropriate than the Random Effect Model. Therefore, the primary regression analysis employs firm fixed effects with robust standard errors.

### 4.3 Main Regression Results

#### Table 3. Fixed Effect Regression Results

Variable	Coefficient	t-statistic	p-value
Environmental	0.012	1.21	0.228
Social	0.009	0.98	0.327
Governance	0.045***	3.67	0.000
Firm Size	0.031**	2.45	0.015
ROA	0.210***	4.12	0.000
Leverage	-0.118**	-2.11	0.036
Growth	0.052*	1.89	0.059

Adjusted R<sup>2</sup> = 0.42

F-statistic significant at 1%

## 4.5 Interpretation of Regression Findings

### 4.5.1 Environmental Performance

The coefficient of environmental performance is positive (0.012) but statistically insignificant ( $p = 0.228$ ). Economically, a 10-point increase in environmental score increases Tobin’s Q by only 0.12, which is relatively small and not statistically distinguishable from zero. This finding suggests that environmental initiatives are not yet fully priced by investors in Indonesia and Malaysia. The result aligns with studies conducted in several emerging markets that report insignificant environmental valuation effects, particularly where regulatory enforcement remains moderate. However, this finding contradicts research in developed markets that documents significant positive environmental effects on firm value. The divergence may reflect differences in investor awareness and institutional maturity. Thus, H1 is not supported.

### 4.5.2 Social Performance

Social performance shows a positive but insignificant coefficient (0.009,  $p = 0.327$ ). This implies that improvements in employee welfare, community engagement, or product responsibility do not significantly influence market valuation during the observation period.

The result is consistent with several prior studies in emerging economies that find limited financial materiality of social initiatives. It suggests that social investments may produce reputational benefits that are not immediately capitalized by the stock market. However, the finding differs from certain developed market studies that report significant positive social performance effects, particularly in countries with high stakeholder activism. Therefore, H2 is not supported.

### 4.5.3 Governance Performance

Governance performance exhibits a positive and statistically significant coefficient (0.045,  $p < 0.01$ ). Economically, a 10-point increase in governance score increases Tobin’s Q by 0.45, representing a substantial valuation premium. This finding strongly supports H3 and aligns with

Agency Theory and Signal Theory. Strong governance reduces agency costs, improves transparency, and mitigates managerial opportunism. In emerging markets characterized by higher information asymmetry, governance signals are particularly valuable. This result is consistent with numerous prior studies that identify governance as the most financially material ESG pillar in emerging markets.

## **5. Conclusion**

This study examines the effect of Environmental, Social, and Governance (ESG) performance on firm value among non-financial companies listed in Indonesia and Malaysia during 2021–2024. By disaggregating ESG into environmental, social, and governance dimensions, this research provides a more detailed understanding of how each pillar influences market valuation in emerging Southeast Asian capital markets. The empirical findings indicate that governance performance has a positive and statistically significant effect on firm value, while environmental and social performance do not show significant impacts. These results suggest that investors in Indonesia and Malaysia place greater emphasis on governance mechanisms that enhance transparency, accountability, and risk mitigation. Governance appears to function as a credible signal that reduces agency conflicts and information asymmetry, which are particularly relevant in emerging markets. In contrast, environmental and social initiatives may generate long-term strategic benefits, but such benefits are not yet consistently reflected in short-term market valuation.

The findings contribute to Agency Theory and Signal Theory by demonstrating that governance quality is financially material in institutional settings where investor protection and regulatory enforcement are still evolving. The results also provide contextual refinement to Stakeholder Theory, indicating that the financial relevance of stakeholder-oriented practices depends on institutional maturity and investor expectations. From a managerial perspective, firms seeking to enhance market value should prioritize strengthening governance structures, including board effectiveness, internal control systems, and transparent disclosure practices. While environmental and social initiatives remain important for sustainability and corporate reputation, governance improvements appear to deliver more immediate capital market recognition. For investors, governance metrics may serve as a critical screening tool when evaluating firms in emerging markets.

This study has several limitations. The relatively short observation period may not fully capture the long-term financial effects of environmental and social investments. The reliance on ESG scores from a single data provider may introduce measurement bias. Additionally, potential endogeneity between firm value and ESG performance cannot be entirely eliminated despite robustness checks. Future research may extend the time horizon, incorporate dynamic panel methods, and explore moderating variables such as ownership structure or industry sensitivity to provide deeper insight into ESG valuation dynamics. Overall, this study highlights that ESG is not uniformly priced across its dimensions in emerging markets. Governance emerges as the most financially relevant pillar, reflecting investor prioritization of risk reduction and institutional credibility. As sustainability regulation and investor awareness continue to develop, the valuation impact of environmental and social performance may evolve over time.

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