

Increasing Corporate Value through ESG: The Role of Financial Performance as a Mediating Variable

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Abstract

This research investigates how ESG implementation impacts Firm Value and explores whether financial performance acts as a mediating variable. Additionally, it assesses the influence of board meeting frequency and board size on Firm Value. The study uses a quantitative methodology, analyzing panel data from companies listed on the ESG IDX during the 2023–2024 period through regression analysis techniques. The findings show that companies demonstrating stronger ESG practices and corporate governance quality typically receive higher investor confidence and more favorable market ratings, leading to an increase in Firm Value. However, neither board meeting frequency nor board size was found to have a statistically significant effect on Firm Value in this model. The mediation analysis also reveals that financial performance does not mediate the relationship between ESG implementation, board meeting frequency, or board size and Firm Value. Thus, these factors appear to influence Firm Value more directly rather than indirectly through changes in financial performance within the observed sample.

Keywords: Corporate Governance, ESG Score, ROA, Firm Value

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1. Introduction

Firm Value is a primary objective for companies because it reflects their ability to fulfill stakeholder expectations. According to Wahyuni et al., (2025), Firm Value can be observed through stock prices, which represent public assessments of a company's performance in the capital market. Enhancing Firm Value is essential for safeguarding the interests of both investors and shareholders (Zalianty & Az'mi, 2025). Similarly, Wijayanti et al., (2025) argue that an increase in Firm Value indicates that management has utilized company resources effectively and efficiently. To attain higher Firm Value, managers are required to focus not only on short-

term achievements but also on the sustainability of long-term corporate goals (Azizah et al., 2025). As explained by Wijayanto & Supanto (2025), company performance is influenced by a combination of internal and external factors. From an internal perspective, management is expected to strengthen transparency and accountability through the implementation of ESG (Environmental, Social, and Governance) practices. In addition, Paramitha & Devi (2024) identify investment policy, financial performance, and dividend policy as important factors affecting Firm Value, while Fauziah & Rafiqoh (2021) emphasize that increasing stock prices serve as an indicator of strong investor confidence in the company's future prospects.

In Indonesia, ESG practices have been implemented across various companies in all sectors. ESG is a set of standards designed to evaluate and formulate policies regarding a company's responsibility toward its business environment (Sadiq et al., 2023). According to Jeanice & Kim (2023), the implementation of ESG demonstrates a company's commitment to its long-term potential. Information regarding a company's ESG practices can serve as crucial information for stakeholders concerning corporate performance. According to Joshua & Chalid (2025), implementing ESG as part of a corporate sustainability strategy is not merely a compliance requirement but also creates long-term Firm Value. ESG initiatives aim to foster environmental sustainability, improve governance quality, decrease information gaps between companies and stakeholders, and lower financing costs.

Consequently, ESG disclosure has become an important mechanism for enhancing transparency, supporting sustainable business operations, and creating long-term value for both companies and investors (Madyan & Widuri, 2023). A similar view was expressed by Noja et al., (2024), who noted that optimally implementing a sustainability strategy through ESG with a focus on increasing Firm Value will benefit both the company and its stakeholders. According to Sihotang & Siregar, (2025), the emergence of global issues such as climate change and carbon emissions has prompted stakeholders to be more selective in assessing corporate performance, particularly regarding the implementation of ESG practices. Rayis et al., (2025) mentioned that ESG practices implemented within a company attract investor interest as they signify a high commitment to business sustainability.

Financial performance is an important factor that influences how investors assess a company and evaluate its future potential. In capital markets, investors rely on financial information as one of the primary

indicators for assessing whether a company is capable of generating sustainable returns and maintaining its competitive position. Strong financial performance indicates management's ability to efficiently allocate resources, manage expenses, and generate earnings from business operations. Therefore, companies that report strong financial outcomes are often considered to have lower investment risk and higher growth opportunities, making them more appealing to both current and potential investors.

Research by Rayis et al., (2025) suggests that strong financial performance improves the efficiency of resource utilization, allowing firms to generate higher profits and strengthen investor confidence. Efficient resource management allows companies to maximize output while minimizing unnecessary costs, resulting in improved profitability and operational effectiveness. This efficiency not only enhances short-term financial outcomes but also supports long-term sustainability by ensuring that the company can continue creating value for its stakeholders. As investors increasingly seek firms with stable and consistent financial performance, companies that demonstrate strong profitability and efficient operations are more likely to attract investment and experience positive market valuation. Profitability ratios, which are widely used indicators in investment assessments, help investors identify companies with financial performance that can provide favorable returns (Sumarno et al., 2023).

For example, Priadi & Wahyudi (2026) reported that ESG performance has no significant effect on a company's financial performance. Their findings indicate that the advantages of ESG adoption may not be directly captured in conventional financial measures, as ESG-related initiatives typically require considerable investment and a longer timeframe before producing observable economic benefits. Companies may incur additional costs associated with environmental management, social responsibility programs, governance improvements, and sustainability reporting. As a result, the positive outcomes of ESG implementation may be more evident in the long term rather than in short-term profitability measures.

Furthermore, Wijayanto & Supanto (2025) found that higher profitability tends to increase a company's Firm Value. From the perspective of Stakeholder Theory, a company's capacity to fulfill stakeholder expectations can strengthen public trust, which in turn contributes to an increase in Firm Value (Remo-Diez et al., 2023). In conclusion, financial performance represents a critical factor influencing investor decisions and Firm Value. Strong profitability, efficient resource

utilization, and the ability to satisfy stakeholder expectations collectively enhance investor confidence and market perception. Supported by empirical evidence from previous studies, financial performance remains an essential indicator of corporate success and a key driver of sustainable value creation for both shareholders and stakeholders.

Legitimacy theory states that a company, as a business organization, operates in alignment with social values and norms. According to Azizah et al., (2025), gaining organizational legitimacy within society will support business sustainability. This implies that companies must meet public expectations, which prompts them to alter their business models to pay closer attention to social, environmental, and corporate governance issues (Naeem et al., 2022). A company is deemed to fulfill its responsibilities regarding social values and norms if its business activities yield a positive impact on the business environment, including society (Loan et al., 2024). ESG serves as a tool to obtain public legitimacy. Furthermore, the implementation of ESG demonstrates a corporate commitment to continuously enhancing its business management image so that it aligns with public expectations (Rayis et al., 2025). Strong legitimacy within society can also increase investor confidence. According to (Wijayanto & Supanto, 2025), stakeholders in a business organization are individuals or entities that hold an interest in the company throughout its operations. Stakeholders such as investors, employees, shareholders, and consumers play a significant role in creating Firm Value. Stakeholder theory explains that a company is accountable for its business activities to all of its stakeholders. The company and its stakeholders constitute an integrated system. Consequently, the implementation of ESG represents a form of accountability to these stakeholders. According to Sumarno et al., (2023) and Chipimo et al.,(2025), information regarding corporate activities, particularly those related to business sustainability, can influence stakeholder decision-making. Ideally, sustainable business management will enhance both the profitability and the reputation of the company.

Signaling Theory states that companies send signals to the market to reduce information asymmetry between managers and investors. Information asymmetry occurs when company managers possess more complete information regarding the firm's performance, prospects, and risks than external stakeholders, particularly investors. This imbalance may create uncertainty among investors when making investment decisions. Therefore, companies are encouraged to provide credible and transparent information to the market as a means of communicating their true quality and future prospects. Through effective disclosure practices, firms can reduce uncertainty, improve investor confidence, and enhance their

reputation in the capital market.

Wijayanti et al., (2025) add that investors obtain information about how a company operates through reports provided by management as well as through its policy-making. Investors will perceive high corporate quality if the company is capable of providing transparent disclosures, such as ESG information (Amalia & Bertuah, 2025). Positive information provided by the company will trigger market reactions and be captured as a positive signal by investors, thereby reducing information asymmetry. A higher level of information disclosure provided by a company will strengthen the positive signal sent to investors regarding the firm (Chipimo et al., 2025). Comprehensive disclosure not only enhances transparency but also demonstrates management's commitment to accountability and ethical business practices. Companies that voluntarily provide detailed information beyond mandatory reporting requirements may be viewed as more trustworthy and less likely to conceal unfavorable information. As a result, investors often interpret extensive disclosure as an indication of superior corporate quality and lower information risk.

According to Joshua & Chalid (2025), the effectiveness of information disclosure, such as ESG reporting, as a signal to investors depends on the company's internal conditions and market positioning. Firms with strong financial performance, established reputations, and competitive advantages may benefit more from ESG disclosures because investors perceive the information as credible and consistent with the company's overall performance. In contrast, companies with weaker financial conditions may not receive the same positive market response, even when providing extensive ESG disclosures. Therefore, the value of disclosure as a signaling mechanism is influenced not only by the quantity of information provided but also by the credibility, consistency, and relevance of that information within the broader corporate context. Overall, Signaling Theory suggests that transparent and high-quality disclosures, particularly ESG related information, play a crucial role in reducing information asymmetry, strengthening investor confidence, and enhancing Firm Value. By communicating credible information regarding their financial and non-financial performance, companies can send positive signals to the market that contribute to favorable investor perceptions and long-term corporate success.

Numerous studies have investigated the association between ESG performance and firm value, establishing it as one of the most extensively examined topics in modern corporate finance and sustainability literature. The growing importance of ESG reflects increasing stakeholder

expectations regarding corporate responsibility, environmental stewardship, and ethical governance practices. Investors, regulators, customers, and society at large are placing greater emphasis on sustainability-related information when evaluating corporate performance and long-term prospects. As a result, researchers have devoted considerable attention to understanding whether ESG implementation contributes to firm value creation and under what conditions such benefits may occur. Rayis et al., (2025) for example, analyzed non-financial firms in Indonesia and concluded that ESG can enhance firm value. In line with these findings, Aydoğmuş et al., (2022) reported that ESG practices have a direct positive impact on firm value. These results support legitimacy theory, which posits that ESG initiatives help firms appear more aligned with societal expectations and their operating environment. Despite extensive research, empirical findings on the direct impact of ESG on firm value are still mixed and have not reached a clear consensus. Joshua & Chalid (2025), for instance, reported that higher ESG scores can reduce firm value, arguing that in developing countries, ESG implementation can impose extra costs and operational limitations on firms.

As a tool for gaining public legitimacy, ESG serves as a marker that a company strives to conduct sustainable business. According to Azizah et al., (2025), the ESG framework offers insight into a company's operational activities and management approach. ESG performance also serves as a tool for stakeholders to evaluate and monitor company performance. The implementation of ESG principles will increase Firm Value. This aligns with Wahyuni et al., (2025), who stated that ESG implementation aligned with stakeholder expectations can create higher Firm Value. According to Arifah (2024) companies that implement ESG principles are able to attract long-term investment. Wijayanti et al., (2025) also argue that the implementation of transparent and accountable corporate governance can increase investor confidence.

Ni'mah & Kusumaningtias (2025) add that optimizing company performance oversight can be achieved through monitoring the board of directors. The board of directors serves as the primary decision-maker, determining the company's direction in achieving long-term goals and maintaining business sustainability. An adequately sized board of directors can enrich the company's competencies, experience, and perspectives, thereby improving the quality of decision-making. Research conducted by Chairani & Siregar, (2021); Azizah et al., (2025) and Wijayanto & Supanto (2025) shows the influence of ESG on Firm Value. H₁: ESG influences Firm Value.

ESG and financial performance are variables that have a strategic relationship. According to Rahma et al., (2025) the ESG implementation mechanism in a company is seen as a form of accountability. ESG implementation can encourage more efficient resource use, thereby maximizing profits (Noja et al., 2024). Financial performance is used by investors as an indicator of company performance. Continuously improving financial performance will attract investor interest, while ESG can be a tool to reduce agency problems and information asymmetry, thus hopefully helping to increase investor confidence. According to Nurhidayanti et al., (2023), one component of ESG is the presence of a board of directors. In this context, the board of directors plays a strategic role because it is responsible for formulating policies, directing business strategies, and ensuring the effective implementation of ESG. Several studies have shown an influence between ESG and financial performance, such as those conducted by Aydoğmuş et al., (2022); Naeem et al., (2022) Sumarno et al., (2023); and Loan et al., (2024). H₂: Financial performance is affected by a firm's ESG performance.

Drawing on Signaling Theory and Stakeholder Theory, the implementation of ESG practices can encourage management to improve and sustain operational efficiency (Necib et al., 2024). Enhanced efficiency can lead to greater profitability, which serves as a positive signal to the market regarding the company's commitment to sustainable business practices. According to Khaulah et al., (2026), financial performance is a key factor influencing how investors perceive a company's value. In addition, Wahyuni et al., (2025) argued that as firm value increases, management should place greater emphasis on ESG implementation while maintaining strong profitability levels. These findings are consistent with the results reported by Zhou et al., (2022) and Necib et al., (2024). H₃: The effect of ESG performance on firm value is mediated by financial performance.

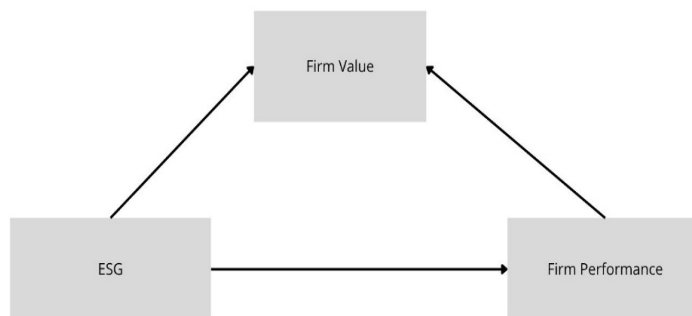


Figure 1. Research Framework

2. Method

This study employed a quantitative research approach to examine the relationship between Environmental, Social, and Governance (ESG) performance, corporate governance characteristics, financial performance, and Firm Value. The quantitative approach was selected because the study aims to test the proposed hypotheses and analyze causal relationships among variables using statistical techniques. The research model investigates the direct effect of ESG performance, board meeting frequency, and board size on Firm Value, as well as the mediating role of financial performance in these relationships.

The population of this study consists of companies listed in the ESG Index of the Indonesia Stock Exchange (IDX) during the 2023–2024 period. The ESG Index was selected because companies included in this index have demonstrated commitments toward sustainable business practices through the implementation of environmental, social, and governance principles. The research data were obtained from secondary sources, including annual reports, sustainability reports, and financial statements published by companies through the official website of the Indonesia Stock Exchange (www.idx.co.id) and company websites.

The sample selection was conducted using a purposive sampling method based on predetermined criteria. The criteria applied in selecting the research sample are presented in Table 1. Companies were selected if they were consistently listed in the ESG Index during the observation period, provided complete information related to ESG scores, financial performance, corporate governance characteristics, and firm value measurements. Companies with incomplete data or extreme outlier values were excluded to ensure the reliability of the statistical analysis.

Table 1. Research Sample Criteria

<i>Criteria</i>	<i>Total</i>
a. Companies listed on the ESG IDX in 2023-2024	56
b. Data outlier	18
c. Companies listed on the ESG IDX with complete data related to the research variables during 2023-2024	38
Total observation data= 38 x 2 years	76

The final sample consists of 38 companies with two years of observation, resulting in 76 firm-year observations. The panel data structure allows the study to capture variations across companies and periods, thereby providing more comprehensive empirical evidence regarding the

relationship between ESG implementation, financial performance, and Firm Value.

The variables used in this study consist of dependent, independent, and mediating variables. Firm Value is used as the dependent variable, while ESG Score, board meeting frequency, and board size are independent variables. Financial performance measured by Return on Assets (ROA) is positioned as a mediating variable. The operational definitions and measurements of each variable are presented in Table 2.

Table 2. Variables and Measurement

<i>Variable</i>	<i>Description</i>	<i>Measurement</i>
Firm Value	Investors' assessment of a company's achievements, which is manifested in the market value of its stock.	$PBV = \frac{\text{Share Price}}{\text{Book Value per Share}}$
ESG Score (ESGs)	A scoring approach designed to assess corporate sustainability and ethical responsibility by considering environmental, social, and governance aspects.	ESG ratings obtained from firms included in the SRI KEHATI Index.
BOD_MEET	Number of board meetings in one period	$BOD_MEET = \sum \text{board meetings}$
BOD_SIZE	Number of board members in one period.	$BOD_SIZE = \sum \text{Number of board members}$
Financial Performance	A metric reflecting a company's ability to increase profits.	$ROA = \frac{\text{net profit}}{\text{Total Assets}} \times 100\%$

3. Result and Discussion

Descriptive statistical analysis was conducted to provide an overview of the characteristics of the research data. Table 3 presents the minimum, maximum, mean, and standard deviation values of the PBV, ROA, ESGs, BOD_SIZE, and BOD_MEET variables used in the study.

Table 3. Descriptive Statistic

	<i>N</i>	<i>Min.</i>	<i>Max.</i>	<i>Mean</i>	<i>Std. Dev</i>
PBV	76	1.00	314.00	127.000	87.72548

ROA	76	16.00	1335.00	522.250	329.37845
ESGs	76	209.00	5043.00	2735.51	1201.26122
BOD_SIZE	76	3.00	16.00	7.1316	2.59919
BOD_MEET	76	3.00	234.00	24.3684	29.16978

The results of the descriptive statistics in Table 3 show that the average BOD_SIZE among the sampled firms is about seven directors. In addition, the relatively low level of data dispersion indicates that the number of board members does not vary substantially across companies, reflecting a comparable board structure within the sample. The BOD_MEET variable shows the results of the frequency of board meetings with a fairly high data distribution, which means there are companies with very low and very high meeting intensity. Furthermore, the ESGs variable indicates that the ESGs of companies in the study are quite varied, thus indicating differences in the level of implementation of ESG aspects between companies. The ROA shows significant variation between companies in generating profits from their assets. Meanwhile, the PBV variable also shows significant differences in the value of the companies in the study sample. The descriptive statistics show a fairly wide distribution of data for each variable, particularly for BOD_MEET, ESGs, ROA, and PBV, reflecting the diverse characteristics of the companies in the study sample.

Table 4. Regression Result 1

<i>Predictor</i>	<i>B</i>	<i>SE</i>	β	<i>t</i>	<i>Sig.</i>
ESGs	0.017	0.008	0.235	2.098	0.039
BOD_MEET	0.563	0.340	0.187	1.654	0.103
BOD_SIZE	4.494	3.829	0.133	1.174	0.244
Intercept	34.333	37.935	–	0.905	0.368
Model	Value				
Statistics					
R ²	0.106				
Adjusted R ²	0.069				
Fitted Equation	PBV = 34.333 + 0.017ESGs + 0.563BOD_MEET + 4.494BOD_SIZE + ε				

Based on Table 4, ESGs is the only variable that has a statistically significant positive effect on firm value ($B = 0.017$; $p = 0.039$), indicating that better ESG performance is associated with higher PBV and improved market valuation. In contrast, BOD_MEET ($B = 0.563$; $p = 0.103$) and BOD_SIZE ($B = 4.494$; $p = 0.244$) show positive but statistically

insignificant relationships with firm value. The model explains 10.6% of the variation in firm value ($R^2 = 0.106$), with an adjusted R^2 of 0.069, indicating limited explanatory power. Overall, ESG performance appears to be the main factor influencing firm value in this study, compared to board characteristics.

Table 5. Regression Result 2

<i>Predictor</i>	<i>B</i>	<i>SE</i>	β	<i>t</i>	<i>Sig.</i>
ESG Score	0.069	0.029	0.252	2.381	0.020**
Board Meeting Frequency	-0.977	1.207	-	-0.809	0.421
Board Size	-41.328	13.577	-	-3.044	0.003***
			0.326		
Constant	652.118	134.510	–	4.848	0.000
Model Statistics					Value
R^2					0.203
Adjusted R^2					0.170
Fitted Equation	ROA = 652.118 + 0.069ESGs – 0.977BOD_MEET – 41.328BOD_SIZE + ϵ				

Based on the regression results in Table 5, ESGs has a positive and significant effect on ROA, with a coefficient of 0.069 and a p-value of 0.020, indicating that higher ESGs is associated with improved profitability. In contrast, BOD_MEET shows a negative but insignificant relationship with ROA (coefficient = -0.977; $p = 0.421$). Meanwhile, BOD_SIZE has a significant negative impact on profitability, as reflected by a coefficient of -41.328 and a p-value of 0.003, suggesting that larger boards may reduce efficiency and weaken decision-making, thereby lowering firm performance. Overall, the model explains 20.3% of the variation in ROA ($R^2 = 0.203$), while the adjusted R^2 of 0.170 indicates a moderate explanatory power of the variables.

Table 6. Sobel Test

	<i>t</i>	<i>Sig.</i>
ESGs→ROA→PBV	1.11	0.26847455
BOD_MEET→ROA→PBV	0.75	0.45033592
BOD_SIZE→ROA→PBV	1.85	0.06357519

According to the Sobel test, ROA does not function as a mediator in explaining the effect of ESG Score, BOD_MEET, and BOD_SIZE on PBV. The absence of a mediating effect is evidenced by insignificant indirect relationships, as all significance values are above the 5% level and the corresponding t-statistics fall short of the critical value of 1.96. As a result,

the empirical evidence does not support the mediation hypotheses involving ROA.

ESG & Firm Value

The findings of this study indicate that ESG scores have a significant influence on Firm Value. This result is consistent with previous studies conducted by Chairani & Siregar (2021), Azizah et al., (2025), and Wijayanto & Supanto (2025), which demonstrated that the adoption of ESG principles contributes positively to enhancing Firm Value. When ESG practices are implemented in accordance with stakeholder expectations, they can further strengthen company value (Wahyuni et al., 2025). In addition, Arifah (2024) argued that ESG adoption serves as an attractive factor for long-term investors, particularly when accompanied by transparent and accountable corporate governance. Such practices help increase investor trust and confidence in the company (Wijayanti et al., 2025).

The results further demonstrate that board meeting frequency and board size do not exert a significant influence on firm value. As noted by Ni'mah & Kusumaningtias (2025), disparities in the number of directors among companies are indicative of differing governance structures. Despite this variation, a larger board is not always associated with superior organizational performance. Excessively large boards often face difficulties in coordination and decision-making due to the need to accommodate diverse viewpoints. Moreover, larger boards can increase operational and administrative costs, which may reduce profitability. As a consequence, investors may perceive the company less favorably, potentially leading to a decline in firm value.

ESG & Financial Performance

The findings reveal that stronger ESG performance is associated with improved financial performance, which is reflected in higher ROA values. This result is consistent with previous studies conducted by Naeem et al., (2022), Sumarno et al.,(2023), and Loan et al., (2024). Stakeholder theory suggests that ESG implementation improves a firm's relationships with various stakeholders, including investors, employees, customers, suppliers, and surrounding communities. Strong stakeholder relationships encourage greater support for corporate activities, enhance customer loyalty, improve employee productivity, and facilitate access to external financing. These benefits contribute to increased revenues and profitability, which are ultimately reflected in higher ROA.

While ESG performance enhances financial performance,

governance-related factors, particularly board size, demonstrate a contrasting effect. As shown in Table 5, board size is found to have a significant negative impact on ROA. This finding suggests that a larger board of directors does not necessarily improve company performance. Consistent with Nurhidayanti et al., (2023) an increase in board size may create inefficiencies in coordination, communication, and decision-making processes. Larger boards often involve diverse opinions and interests, making it more difficult to reach consensus on strategic issues. Consequently, decision-making may become slower and less effective, limiting the organization's ability to respond promptly to business opportunities and challenges.

Financial Performance as a Mediating Variable

Table 6 shows that investors make investment decisions based on the role of ESG, without waiting for company performance to improve. For investors, ESG is part of long-term investment risk mitigation. According to Utama & Dewi (2024), state that ESG implementation in companies is mainly motivated by compliance with POJK No. 51/POJK.03/2017, which obliges certain Indonesian firms and financial institutions to adopt sustainable finance principles and disclose sustainability reports. Compliance with these regulations demonstrates a company's commitment to meeting stakeholder expectations and adhering to evolving standards of corporate responsibility. Consequently, ESG adoption helps improve a company's legitimacy and increases public confidence. According to Legitimacy Theory, organizations attempt to conform their activities to social values and expectations to obtain legitimacy and stakeholder approval. Therefore, companies that actively implement ESG practices may benefit from enhanced legitimacy, which can positively influence investor perceptions and firm value regardless of immediate financial outcomes. Furthermore, ESG implementation has a more direct impact on market perception and social legitimacy than on short-term financial performance, particularly profitability. Investors increasingly recognize that ESG initiatives can reduce exposure to environmental, social, and governance risks that may threaten a company's long-term viability.

4. Conclusion

The findings revealed that companies with stronger ESG performance tend to achieve higher market valuations. Investors increasingly view ESG implementation as an important indicator of long-term sustainability, effective risk management, and corporate responsibility. Companies that actively address environmental issues, fulfill social responsibilities, and

maintain sound governance practices are perceived as having greater potential to create sustainable value. As a result, these firms gain higher investor confidence, which contributes to increased firm value. This finding supports Stakeholder Theory, which emphasizes the importance of addressing stakeholder interests, and Legitimacy Theory, which suggests that socially responsible firms are more likely to gain public acceptance and legitimacy. The findings provide important practical implications for both companies and investors. Companies should strengthen ESG implementation and integrate sustainability initiatives into their business strategies, as ESG contributes directly to firm value and financial performance. For investors, ESG-related information should be considered alongside traditional financial indicators when evaluating investment opportunities. By incorporating both financial and non-financial factors into decision-making, investors can better identify companies with strong long-term growth potential and sustainable value creation.

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