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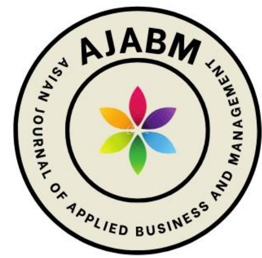

ESG Rating and Firm Value in Emerging Market: Investigating the Mediating Role of Financial Performance

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ABSTRACT

This study examines the impact of ESG Rating on Firm Value, with Financial Performance as a mediating variable, using a sample of companies included in the IDX ESG Leaders index for the years 2021–2023. The analysis was conducted using PROCESS Macro and bootstrapping methods to identify the direct and indirect effects of ESG practices on Firm Value. The findings reveal that ESG Rating does not have a direct effect on Firm Value, nor does Financial Performance mediate this relationship. These results suggest that in emerging markets like Indonesia, the direct financial benefits of ESG practices are not fully recognized by investors, possibly due to a lower level of awareness and appreciation of sustainability. This study offers insights into the challenges and opportunities for ESG implementation among companies in emerging markets to enhance long-term firm value.

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INTRODUCTION

The introductory section is here; you can provide logical and phenomenological reasons for conducting your research. You must also provide a clear explanation of your paper's contribution to knowledge enrichment. That could come in the description of a niche sample (capturing a unique sample), theory enrichment, or interesting results (novelty if available). A short and to-the-point introduction is essential in this paper.

Firm value is a fundamental indicator reflecting the market's perception of a company's potential and financial stability. This value is frequently used by stakeholders and investors to evaluate the company's long-term prospects, including financial stability and growth potential. In an increasingly competitive business era, the role of non-financial indicators like ESG (Environmental, Social, and Governance) is becoming more critical, as it enhances the company's appeal to investors and stakeholders concerned with sustainability (Mikołajek-Gocejna, 2024; Yu & Xiao, 2022). ESG enables companies to demonstrate responsibility toward the environment and society, which is increasingly viewed as a determinant of firm value (Aboud & Diab, 2018).

The global investment trend reveals that investors now consider not only financial aspects but also ESG risks in their investment decisions. This phenomenon became increasingly evident during the COVID-19 pandemic, where investors began shifting funds towards companies with lower ESG risks to reduce market volatility impact (Ferriani & Natoli, 2021). ESG serves not only as a risk mitigation mechanism but also as a way to maintain company stability and appeal in dynamic markets. Companies that effectively manage ESG risks tend to have stronger financial stability and better reputations (Bahadır & Akarsu, 2024; Cohen, 2023).

Implementing ESG across various industry sectors brings numerous additional benefits. Studies in extractive sectors, such as mining, show that ESG risk assessments are crucial in determining a company's operational feasibility, especially in vulnerable areas like indigenous communities or natural ecosystems. Proper management of environmental and social risks contributes to public acceptance and smoother operational permitting (Fikru et al., 2024; Gawęda, 2022). Research in Asian markets suggests that companies focused on ESG aspects have stronger stakeholder relationships and tend to achieve higher firm values (Zainuddin et al., 2024; Setiawati & Hidayat, 2023; Chang & Lee, 2022).

However, not all research agrees on the positive impact of ESG on firm value. Research on the Polish market indicates that compliance costs with ESG standards in some industry sectors may be higher than the direct benefits, especially in capital-intensive sectors requiring significant resources (Mikołajek-Gocejna, 2024). Other research highlights varying ESG effects in emerging markets, where sustainability practices might not always yield short-term financial gains (Chang & Lee, 2022).

Corporate financial performance can play a crucial role in linking ESG practices with firm value. Companies with strong financial performance often

have greater capacity to support and implement ESG initiatives sustainably, which can enhance the company's reputation and appeal among sustainability-conscious investors. However, this dynamic is not uniform across sectors or markets, necessitating a deeper understanding of how financial performance can strengthen or mediate the influence of ESG in diverse industrial and economic contexts (Rau & Yu, 2024; Wu et al., 2022).

Stakeholder Theory provides a robust theoretical foundation to understand how and why ESG can impact firm value. The theory suggests that companies attentive to stakeholder interests, including customers, communities, and governments, tend to achieve better long-term performance. Effective ESG risk management can boost public trust and strengthen company relationships with communities, contributing to higher firm value (Mikołajek-Gocejna, 2024). Within this context, companies committed to ESG are regarded as having better long-term prospects.

This study aims to fill the gap in literature concerning the impact of ESG on firm value in emerging markets, with a focus on Indonesia. By positioning financial performance as a potential mediating variable, this research aspires to provide a deeper perspective on how ESG influences firm value in diverse contexts, and to offer guidance for regulators and companies in integrating ESG as part of an effective sustainability strategy.

LITERATURE REVIEW

Stakeholder Theory

Stakeholder Theory posits that a company's responsibilities extend beyond shareholder interests to include the needs and interests of a broader set of stakeholders affected by the company's operations. Originally introduced by Freeman in 1984, this theory underscores the importance of considering the social and environmental impact of business activities on communities, employees, customers, suppliers, and the government (Huang, 2022). In the context of ESG (Environmental, Social, and Governance), this theory has become increasingly relevant, as companies proactive in managing social and environmental responsibilities are seen as more attractive by investors and society, particularly in a modern business environment with a heightened focus on sustainability (Alnafrah, 2024; Christianna et al., 2023; Sekar & Krishnan, 2022). ESG supports companies in applying Stakeholder Theory principles by focusing on the social and environmental aspects that stakeholders are progressively expecting.

The adoption of ESG practices within companies is driven by the need to build long-term positive relationships with stakeholders. Recent studies indicate that companies that effectively manage social and environmental responsibilities through ESG practices can reduce conflict, enhance reputation, and strengthen customer and employee loyalty (Habib et al., 2024). By meeting stakeholder expectations, companies not only fulfill sustainability standards but also improve their competitive edge in markets sensitive to sustainability issues (Litvinova et al., 2023). Companies that prioritize ESG are generally more adaptable to regulatory and community expectations, making Stakeholder

Theory a solid foundation for understanding the growing importance of ESG management in current business practices.

Based on Stakeholder Theory principles, companies that meet stakeholder expectations through ESG implementation are viewed as having better long-term stability and sustainability. Recent research has shown that integrating ESG into business strategy not only impacts company reputation but also contributes to long-term firm value (Ho & Hsu, 2024). Thus, Stakeholder Theory provides a theoretical basis that company success is measured not only by financial achievements but also by the company's ability to meet stakeholder expectations and minimize social and environmental risks that could disrupt operational sustainability (Sabirali, 2024; Fuadah et al., 2023; Ashrafi et al., 2020).

ESG Rating

ESG Rating is an essential indicator used to evaluate a company's performance in three core areas: Environmental, Social, and Governance. ESG Ratings enable investors and other stakeholders to assess a company based on its sustainability impact and activities, as well as how it manages non-financial risks that may affect its long-term reputation and stability (Jiao, 2024; Sabirali, 2024). ESG Rating is increasingly used as a benchmark for assessing a company's commitment to sustainability, appealing to investors who are conscious of environmental and social risks (Lhutfi et al., 2024).

Different ESG rating providers utilize varying assessment methodologies. For instance, MSCI employs a risk-based approach that considers relevant factors for each industry, with a rating scale from AAA to CCC, reflecting a company's readiness to manage ESG risks. Sustainalytics evaluates companies based on risk exposure and risk management, measuring a company's exposure to material ESG risks and its capacity to manage these risks, with a rating scale from negligible risk to severe risk. S&P Global incorporates ESG factors into its resilience analysis, assessing companies based on their contributions to sustainability and their ability to withstand long-term risks, which is essential for understanding long-term stability. Bloomberg focuses on the transparency of publicly reported ESG data, particularly regarding carbon disclosure and sustainability policies, providing insights into a company’s sustainability commitment based on available data.

Integrating Environmental, Social, and Governance (ESG) assessment methodologies has become crucial for investors in managing long-term sustainability-related risks. Recent research indicates that comprehensive ESG assessments can identify risks not typically reflected in traditional financial reports, thereby aiding investors in making better decisions and positively impacting company stability. For instance, a systematic literature review found that ESG factors are increasingly incorporated into investment strategies, as growing evidence points to their impact on firm performance and risk management (De Giuli et al., 2024).

Additionally, updated methodologies for assessing ESG competitiveness have been developed, aligned with regulatory frameworks like the EU

Taxonomy, which provide clearer guidance on ESG risks and opportunities, helping investors understand a company's sustainability commitment more comprehensively (Tkachenko et al., 2023). This shift reflects a broader trend in sustainable finance, making understanding the interaction between ESG factors and financial performance increasingly crucial for wise investment decisions (Jain & Tripathi, 2023).

The Role of ESG in Enhancing Firm Value

The implementation of ESG (Environmental, Social, and Governance) is increasingly recognized as a factor that can enhance firm value in global markets. ESG encompasses aspects that not only directly impact company operations but also affect the company's image among stakeholders, including investors, consumers, and communities. In the modern business world, companies with strong ESG scores are considered more capable of facing complex challenges, such as climate change, social inequality, and demands for transparency and good governance (Agarwala et al., 2024; R. Chen, 2023). ESG serves as a means for companies to demonstrate their commitment to social and environmental responsibilities, thereby strengthening their appeal and financial stability in the eyes of investors who are increasingly concerned about sustainability (Sousa & Cuevas, 2023; Doni et al., 2022).

Effective ESG management positively impacts investor confidence and market valuation. Research shows that institutional investors are more likely to be attracted to companies with strong ESG scores, as these companies are considered more stable and less vulnerable to non-financial risks (Feng et al., 2024; Yap et al., 2024). For example, major investors like BlackRock and Vanguard now require their investment portfolios to consider ESG performance as a means of maintaining a more stable portfolio in the long term (Huang, 2022). During the COVID-19 pandemic, this trend became increasingly evident, with companies exhibiting strong ESG performance showing greater resilience to market volatility than those without robust ESG management systems. Thus, ESG not only acts as a risk mitigation tool but also as a strategy to enhance a company's appeal to investors and other stakeholders (Ferriani & Natoli, 2021).

Active ESG management also boosts a company's ability to comply with increasingly stringent regulations and adapt to evolving social and environmental demands. ESG implementation in various industry sectors, particularly those with significant environmental impacts like energy and manufacturing, helps companies reduce potential conflicts and anticipate legal risks related to environmental pollution or human rights violations (Mikołajek-Gocejna, 2024). By aligning with regulations increasingly focused on sustainability, companies not only maintain their operational licenses but also strengthen relationships with local communities and consumers, essential elements supporting long-term stability (Setiawati & Hidayat, 2023).

However, ESG implementation presents several challenges, particularly regarding costs and resources required. Studies show that high-capital sectors, such as mining and energy, often face significant cost burdens to comply with stringent ESG standards, which can impact profitability in the short term

(Bandeira et al., 2024). Research in the energy and natural resources sectors in Europe indicates that while ESG enhances reputation, its implementation can reduce company competitiveness in terms of operational costs (Fikru et al., 2024; Wang, 2024). This suggests that ESG success in increasing firm value largely depends on cost structures and the company's ability to balance sustainability commitments with financial efficiency (Zioło et al., 2023; Gawęda, 2022).

Financial Performance as a Mediating Variable

Sustainability in corporate activities is becoming a primary concern for stakeholders, especially investors who seek long-term stability in their investments. The implementation of ESG principles enables companies to be more responsive to environmental, social, and governance issues, ultimately adding value in the eyes of investors. However, this added value is not always directly reflected in firm value, as achieving sustainability typically involves strategic efforts that require processes and investment (W. Chen et al., 2024; Maaloul et al., 2023; Usman et al., 2020).

In this context, financial performance often becomes a crucial element that links ESG implementation to firm value. Companies successfully implementing ESG principles tend to demonstrate financial stability, operational efficiency, and higher profitability. The stable cash flow generated from sound resource management and environmental risk mitigation increases the company's appeal to institutional investors prioritizing sustainability (O'Sullivan, 2024). Studies also indicate that stable institutional investors (long-term investors) encourage companies to care more about environmentally friendly practices, ultimately enhancing financial performance while attracting new investors (Li et al., 2022; Adamska & Dąbrowski, 2021).

Stakeholder Theory supports this understanding, emphasizing that companies prioritizing environmental and social responsibilities can achieve better reputations and operational efficiency. These benefits provide a competitive advantage in the long term, reinforcing financial performance by increasing trust and loyalty from various parties, including consumers and investors (Yankovskaya et al., 2022).

Improving financial performance through such achievements, especially in sectors concerned with sustainability, demonstrates that ESG efforts have the potential to deliver significant financial impacts. This strengthens the understanding that good financial performance not only supports company stability but also serves as a critical link showing how ESG implementation can optimize firm value, especially in achieving long-term business sustainability.

Conceptual Framework, Research Model, and Hypothesis

The conceptual framework of this study is grounded in Stakeholder Theory, which posits that a company's success relies not only on fulfilling shareholder interests but also on meeting the expectations of all stakeholders, such as employees, consumers, communities, and government entities (Freeman, 1984). Applying the principles of Environmental, Social, and Governance (ESG) serves as a company's effort to fulfill the social and

environmental responsibilities expected by stakeholders. Effective ESG implementation not only enhances the company's reputation but can also positively impact financial performance, thereby reinforcing firm value in the eyes of investors (Jiao, 2024; Sabirali, 2024).

This study also considers financial performance as a mediating variable in the relationship between ESG and firm value. Based on previous studies, companies that effectively implement ESG practices tend to exhibit financial stability, operational efficiency, and higher profitability. Financial stability, in the context of sustainability, bolsters the confidence of institutional investors increasingly focused on sustainability aspects in their investment decisions (O'Sullivan, 2024). Thus, financial performance serves as a pathway linking ESG implementation with an increase in overall firm value (Huang, 2022). The structure of the conceptual framework for this study is illustrated in the following figure:

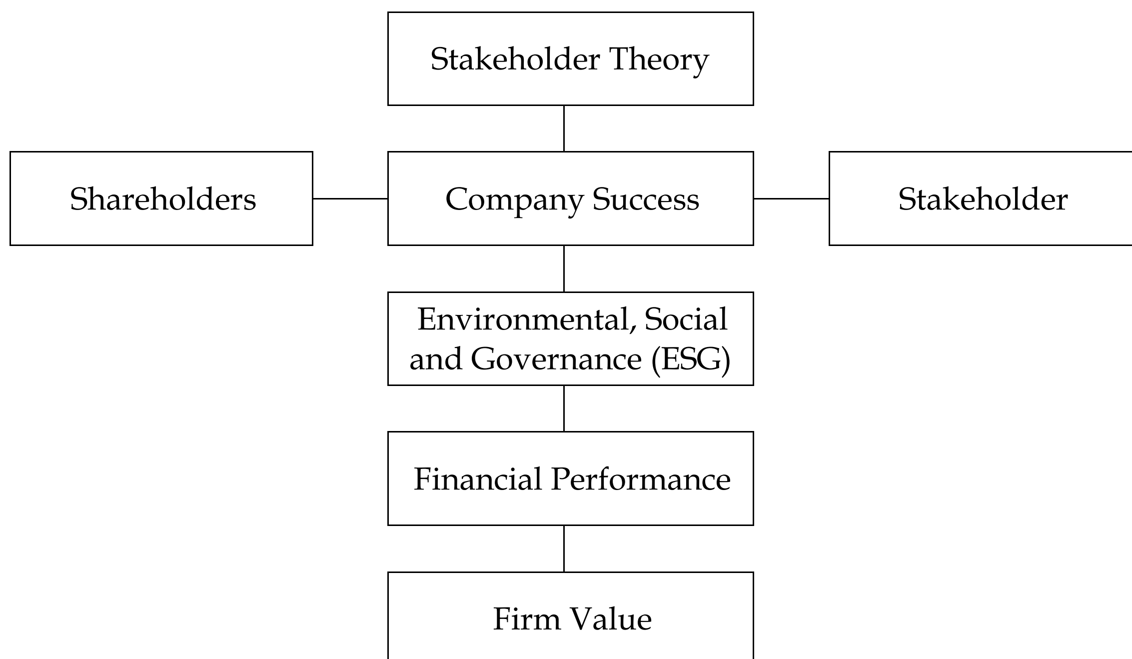

Figure 1. Conceptual Framework

Based on this conceptual framework, the following research model illustrates the relationships between variables, where ESG Rating is the independent variable, firm value is the dependent variable, and financial performance serves as the mediating variable. This model is designed to assess the impact of ESG Rating on firm value, both directly and through the mediating role of financial performance.

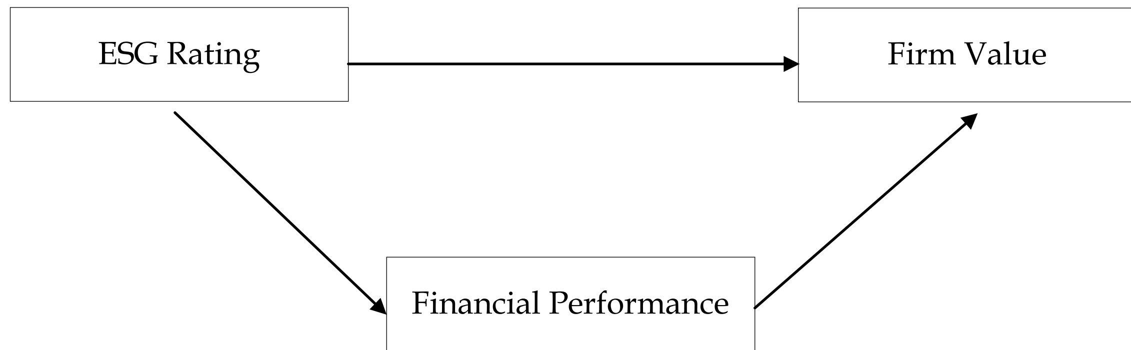

Figure 2. Research Model

Based on the developed research model, the hypotheses of this study are formulated as follows:
H1: ESG Rating affects firm value.
H2: Financial performance mediates the effect of ESG Rating on firm value.

METHODOLOGY

Sampling

The population of this study consists of companies listed in the IDX ESG Leaders Index on the Indonesia Stock Exchange (IDX) during the 2021–2023 period. These companies were selected due to their exemplary performance in sustainability practices, making them relevant for examining the relationship between ESG Rating, Financial Performance, and Firm Value. The sampling method applied in this study was purposive sampling, designed to identify companies that meet specific criteria. The chosen criteria required companies to be listed in the IDX ESG Leaders Index and to have complete data available through Annual Reports and Sustainability Reports for the years 2021–2023. By focusing on these specific characteristics, the study aimed to gather a sample that could provide a comprehensive understanding of the ESG practices within firms demonstrating a strong commitment to sustainability. Ultimately, 20 companies met these criteria and were included as the sample for analysis.

Data Collection

Data for this study was collected from publicly accessible sources, specifically the Annual Reports and Sustainability Reports of the selected companies for the period of 2021–2023. The primary focus was on gathering comprehensive information to evaluate the ESG Rating, Financial Performance, and Firm Value of each company. The ESG Rating data was sourced from Sustainalytics reports available through the Indonesia Stock Exchange (IDX), which provided insights into each company's risk levels associated with environmental, social, and governance factors. Additionally, financial data required to calculate firm value and measure financial performance was extracted from the companies' published reports. By leveraging these reliable, publicly available sources, the study ensured a consistent and accurate dataset for analysis.

Measures

The study utilized three primary variables: ESG Rating, Firm Value, and Financial Performance, each measured with a specific approach to ensure accurate and relevant data.

a. *ESG Rating (Independent Variable)*
   ESG Rating was assessed using the ESG Risk Rating provided by Sustainalytics, which evaluates a company's exposure to risks related to environmental, social, and governance factors (Fikru et al., 2024; Cohen, 2023; Ferriani & Natoli, 2021). This rating serves as an indicator of the company’s commitment to sustainability practices, where a higher risk rating implies a greater level of sustainability-related risk that may impact the company’s stability and reputation.
b. *Firm Value (Dependent Variable)*
   Firm value was measured using Tobin’s Q ratio, which is calculated as the ratio between the market value of a company’s equity and its total assets (Gawęda, 2022; Wu et al., 2022; Yu & Xiao, 2022). This ratio reflects the market’s perception of a company’s growth potential and financial stability, making it an effective proxy for firm value in the context of investor sentiment and market valuation.
c. *Financial Performance (Mediating Variable)*
   Financial performance was represented by Return on Assets (ROA), calculated by dividing net income by total assets (Zainuddin et al., 2024; Setiawati & Hidayat, 2023). ROA is a widely recognized indicator of a company’s efficiency in utilizing its assets to generate profits, with a higher ROA suggesting better financial performance and resource management.

Data Analysis Technique

The data analysis in this study was performed using PROCESS Macro Version 4.2 by Andrew F. Hayes within SPSS software. This tool was chosen for its ability to conduct mediation analysis, which was essential for exploring both the direct and indirect effects between the variables in this study. The analysis specifically focused on determining whether Financial Performance mediates the relationship between ESG Rating and Firm Value.

To estimate the indirect effects accurately, a bootstrapping method was employed with 5,000 resamples. Bootstrapping was selected due to its robustness in handling violations of classical assumptions, such as normality. This resampling technique generates parameter estimates and builds accurate confidence intervals without needing the data to be normally distributed, thereby ensuring more robust and valid results (Kostanek et al., 2024; Mokhtar et al., 2023; Hayes & Little, 2022; Preacher & Hayes, 2008). The study established a 95% confidence interval to determine the significance of the mediation effect. If the confidence interval for the indirect effect (BootLLCI and BootULCI) does not include zero, the mediation effect is considered significant (Preacher & Hayes, 2008).

RESEARCH RESULTS

Descriptive Analysis

The table below presents the descriptive statistics for the variables ESG Risk Rating, Return on Assets (ROA), and Tobin's Q, generated using the bootstrapping method with 5,000 samples. This table provides essential information, including the minimum, maximum, mean, standard deviation, and 95% confidence intervals for each variable. These statistics offer an initial overview of the distribution and variability of each variable, setting the foundation for further hypothesis testing and analysis.

Table 1. Descriptive Statistics

			Bootstrap[a]			
					95% Confidence Interval	
		Statistic	Bias	Std. Error	Lower	Upper
ESG Risk Rating	N	60	0	0	60	60
	Minimum	11.31				
	Maximum	29.71				
	Mean	22.52083	0.000439	0.674973	21.18505	23.83733
	Std. Deviation	5.219121	-0.042488	0.323263	4.508176	5.782800
ROA	N	60	0	0	60	60
	Minimum	1.55				
	Maximum	95.25				
	Mean	23.874	0.0154	3.1465	18.1109	30.2342
	Std. Deviation	24.65803	-0.36617	2.9963	17.94835	29.80983
TOBIN'S Q	N	60	0	0	60	60
	Minimum	0.127883				
	Maximum	114.2650				
	Mean	6.362999	-0.019760	2.502468	2.104711	11.92333
	Std. Deviation	19.56217	-1.277457	6.227292	2.972002	29.48473
Valid N (listwise)	N	60	0	0	60	60

a. Unless otherwise noted, bootstrap results are based on 5000 bootstrap samples

The ESG Rating (ESG Risk Rating) in the sample ranges from 11.31 to 29.71, with a mean of 22.52 and a standard deviation of 5.22. This range indicates varying levels of adherence to sustainability practices among the companies in the IDX ESG Leaders sample. Companies with lower ESG scores are associated with lower environmental, social, and governance risks, whereas companies with higher scores face greater risks in these aspects. The variability (standard deviation of 5.22) suggests that not all companies in the sample exhibit a uniform level of ESG practice adoption; most companies tend to fall around the middle of the spectrum.

In terms of Financial Performance, measured by Return on Assets (ROA), values range from 1.55 to 95.25, with a mean of 23.87 and a standard deviation

of 24.66, indicating substantial variation in profitability among the companies. Higher ROA values reflect greater efficiency in utilizing assets to generate profits, implying that companies with high ROA are considered to have better financial performance. However, the large standard deviation suggests significant diversity in asset efficiency across companies, likely due to differences in strategies, industry sectors, or asset structures.

Firm Value, represented by Tobin's Q, exhibits the greatest variability, with a range from 1.28 to 114.27. The mean Tobin's Q of 6.36 indicates that, on average, these companies are valued by the market at several times their asset value, reflecting positive expectations of growth or future profitability. However, the high standard deviation (19.56) suggests that companies in the sample are not uniformly valued; some are valued significantly above their asset base, while others are closer to or even below their asset value.

Hypothesis Testing

The analysis results obtained from PROCESS Macro are presented in Tables 2 and 3, showing the calculations of both the direct and indirect effects between the independent variable (ESG Rating), the mediating variable (Financial Performance), and the dependent variable (Firm Value).

Table 2. Direct Effect Table Analysis

Effect	se	t	p	LLCI	ULCI
-.7016	.4859	-1.4441	.1542	-1.6746	.2713

Source: Processed from secondary data, 2024.

Table 2 presents the results of the direct effect analysis of ESG Rating on Firm Value. The analysis shows a direct effect coefficient of ESG Rating on Firm Value of -0.7016, with a standard error of 0.4859. The t-value is -1.4441, and the p-value is 0.1542, which is greater than 0.05, indicating that the direct effect of ESG Rating on Firm Value is not significant at a 95% confidence level. Additionally, the confidence interval (LLCI = -1.6746; ULCI = 0.2713) includes zero, which further supports the insignificance of the direct effect of ESG Rating on Firm Value. Based on these results, the first hypothesis, which states that ESG Rating has an effect on Firm Value, cannot be accepted. This finding suggests that ESG Rating does not have a direct influence on Firm Value within the sample.

Table 3. Indirect Effect Table Analysis

	Effect	BootSE	BootLLCI	BootULCI
FP	-.0047	.0502	-.0640	.1385

Source: Processed from secondary data, 2024.

Table 3 presents the results of the indirect effect analysis of ESG Rating on Firm Value through Financial Performance as a mediating variable. The coefficient for the indirect effect of ESG Rating on Firm Value through Financial

Performance is -0.0047, with a bootstrapped standard error of 0.0502. The bootstrapped confidence interval for this indirect effect is BootLLCI = -0.0640 and BootULCI = 0.1385. Since this confidence interval includes zero, the mediation effect of Financial Performance between ESG Rating and Firm Value is not significant at the 95% confidence level. Based on these findings, the second hypothesis, which posits that ESG Rating affects Firm Value through Financial Performance as a mediator, cannot be accepted. This result suggests that Financial Performance does not serve as a mediating factor in the relationship between ESG Rating and Firm Value.

DISCUSSION

The primary objective of this study was to examine the direct and indirect effects of ESG Rating on Firm Value, with Financial Performance acting as a mediating variable. Grounded in Stakeholder Theory, this research contributes to the understanding of ESG practices in emerging markets, specifically Indonesia, by exploring whether sustainability efforts align with stakeholder interests to create financial benefits for companies.

Stakeholder Theory posits that companies enhance long-term value by addressing the interests of all stakeholders, including employees, communities, and customers, rather than focusing solely on shareholders. ESG practices theoretically strengthen stakeholder relationships, enhance corporate reputation, and mitigate non-financial risks, which should positively influence firm value. However, the results of this study reveal that ESG Rating does not have a significant direct effect on Firm Value, nor does Financial Performance mediate this relationship.

One possible explanation, through the lens of Stakeholder Theory, is that while ESG practices are designed to build trust and meet stakeholder expectations, in emerging markets such as Indonesia, the translation of these efforts into financial gains may take longer. In developing economies, there may be limited awareness or demand from stakeholders—especially investors—for companies to prioritize ESG. This lack of immediate stakeholder response could explain why the anticipated financial impact of ESG practices on firm value is not yet significant. (Chang & Lee, 2022) support this perspective, suggesting that in emerging markets, stakeholders—including investors—may not fully recognize the value of ESG, leading to muted effects on financial performance and firm value.

Furthermore, in industries where implementing ESG requires high upfront costs, such as capital-intensive or high-risk sectors, the financial burden may even overshadow any potential reputational gains. As Mikołajek-Gocejna (2024) noted, these sectors may face implementation challenges that result in increased costs without corresponding financial returns. This perspective aligns with Stakeholder Theory, as these companies may be meeting stakeholder demands primarily to maintain legitimacy or comply with regulations, rather than achieving a direct financial advantage.

From a theoretical standpoint, these findings suggest that the influence of ESG on firm value might depend on the level of stakeholder awareness and the

maturity of the market. In developed markets where ESG is more widely valued, companies may see a more immediate return on their investments in sustainability practices. However, in emerging markets, the benefits of ESG might be realized only over the long term, as market stakeholders gradually increase their appreciation for corporate sustainability efforts.

Given these findings, managers in emerging markets should view ESG initiatives as part of a long-term strategy to build relationships with stakeholders rather than expecting immediate financial returns. Building ESG practices may still contribute to stakeholder trust and corporate reputation, aligning with the broader objectives of Stakeholder Theory. Over time, as stakeholder awareness and appreciation for ESG increase, these practices could lead to financial benefits.

This study is not without limitations. The sample is restricted to companies listed in the IDX ESG Leaders index, which may limit generalizability to other sectors in Indonesia. Additionally, the cross-sectional design constrains the ability to capture long-term effects of ESG practices on firm value. Future research could address these limitations by including a wider range of companies and adopting a longitudinal design to observe how ESG impacts evolve over time.

Moreover, future studies might explore how sectoral and cultural differences affect the ESG-firm value relationship, as the strength of stakeholder expectations regarding ESG may vary. Examining how policy developments and stakeholder education influence the adoption and impact of ESG could also provide insights into how the financial benefits of ESG might be strengthened in emerging markets.

CONCLUSION AND RECOMMENDATION

The results of this study reveal that financial performance plays a significant mediating role in the relationship. Firms with higher ESG ratings tend to improve financial performance, which in turn strengthens firm value. The study also highlights the importance of integrating ESG strategies in business operations as a means to create long-term value for stakeholders while increasing competitiveness in the global market. The findings provide important implications for managers, investors and policy makers in prioritizing sustainability as part of strategic decisions in emerging markets.

Based on the research findings, firms in emerging markets are advised to integrate ESG (Environmental, Social, and Governance) principles into their business strategies and improve transparency of sustainability reporting to attract investors and strengthen firm value. Investors are also advised to consider ESG ratings as a key factor in investment decision-making, while policymakers need to encourage regulations that support the adoption of ESG practices through incentives and sustainability literacy. These measures can create synergies between sustainability, financial performance and firm value, while promoting more sustainable economic development in emerging markets.

ADVANCED RESEARCH

This study confirms the strategic role of ESG (Environmental, Social, and Governance) in enhancing firm value in emerging markets through the mediation of financial performance. By demonstrating a causal relationship between ESG implementation, improved financial performance, and strengthened firm value, this study opens up further research opportunities related to contextual factors such as local regulations, technology adoption rate, and corporate culture in strengthening ESG effectiveness. In addition, exploration of the long-term impact of ESG investments on firms' resilience to economic or environmental crises may provide new insights. Future research may also adopt a cross-country comparative approach to evaluate the influence of institutional variables, such as the quality of government governance and financial market stability, in moderating the relationship between ESG and firm value. These findings offer valuable perspectives for integrating sustainability as a key pillar of business strategy, especially amidst increasing global demands for corporate social and environmental responsibility.

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