

Impact of ESG Performance on Firm Value: A Comparison of Emerging and Developed Markets

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ABSTRACT: This study examines the influence of Environmental, Social, and Governance (ESG) performance on firm value, comparing emerging and developed markets, focusing on Indonesia. While ESG's global impact on firm value is well-documented, research on its effects in Indonesia and similar markets is limited. Developed economies benefit from robust regulatory frameworks and investor demand for ESG integration. In contrast, Indonesia shows an inconsistent ESG-firm value relationship influenced by regulatory progress, investor awareness, and socioeconomic factors. The study aims to: (1) evaluate ESG's impact on firm value in Indonesia, (2) identify contextual factors mediating this relationship, and (3) determine which ESG dimensions—Environmental, Social, or Governance—most significantly affect valuation. A Structured Literature Review (SLR) of studies from 2020 to 2024 provides insights into ESG impacts in emerging and developed markets, emphasizing Indonesia. Findings reveal that ESG performance generally enhances firm value in Indonesia, with Governance having the most decisive influence. Governance promotes investor confidence and stability, which is highly valued in Indonesia's market. Social factors, such as community engagement, also contribute to firm value, aligning with Indonesia's emphasis on corporate social responsibility. Environmental factors, however, show limited impact due to low domestic investor prioritization and weak regulatory enforcement. ESG adoption in Indonesia is driven mainly by foreign investors and multinational corporations adhering to global standards. To enhance ESG's role in firm value, Indonesian regulators should mandate ESG disclosures and incentivize green finance. Firms must focus on governance and social initiatives to build investor confidence.

Keywords: ESG Performance, Firm Value, Emerging Markets, Development Market.



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INTRODUCTION

The importance of environmental, social, and governance (ESG) factors in shaping corporate strategies has been overgrown over the last decade, particularly in how firms create long-term value and manage risks. Formulated initially as ethical guidelines, ESG criteria have evolved into crucial metrics for evaluating a company's stability and growth potential. While developed markets have fully integrated ESG metrics into investment appraisals—driven by robust regulatory frameworks and active investor demand—emerging markets, such as Indonesia, are only beginning to embrace these standards. This shift toward ESG is essential for raising transparency, governance, and accountability standards within corporations in these regions (Fischer & Sawatzki, 2021).

However, the pathway for ESG adoption in emerging markets faces unique hurdles, influenced by evolving regulatory landscapes, varying investor awareness, and region-specific socioeconomic factors (Gillan et al., 2021).

In Indonesia, where ESG practices are still in the nascent stages of adoption, the inconsistent impact of ESG on firm valuation highlights a significant gap in research. Studies in developed economies suggest that ESG initiatives consistently enhance firm value by aligning with investor expectations and stringent regulatory requirements (Bao & Sadiq, 2024). However, the extent to which these findings can be generalized to emerging economies remains unclear. Indonesia, in particular, presents a unique context due to its mixed regulatory progress, fluctuating investor interest, and reliance on foreign capital that often brings external ESG expectations. This research addresses a critical gap by focusing on how ESG factors impact firm value, specifically within Indonesia, contrasting these findings with those from developed markets to understand better how local conditions mediate the ESG-firm value relationship.

The research objectives of this study are threefold: (1) to analyze how ESG performance affects firm value within Indonesia, (2) to identify and examine the contextual factors, such as regulatory frameworks and investor behavior, that mediate this relationship in an Indonesian context, and (3) to evaluate which specific dimensions of ESG (Environmental, Social, Governance) exert the most significant influence on firm valuation within Indonesia compared to developed markets. This study fills a notable research gap, as previous literature often generalizes ESG impacts across markets or focuses predominantly on developed economies, overlooking the unique challenges and constraints present in emerging markets like Indonesia (Zhang & Liu, 2022).

To address these objectives, this study employs a Structured Literature Review (SLR) covering research from 2020 to 2024. The SLR methodology enables a comprehensive and unbiased examination of recent literature, ensuring that findings are rigorously sourced, screened, and synthesized to capture the current state of ESG performance in both emerging and developed markets. This structured approach is particularly relevant in fields such as ESG, where research rapidly evolves, allowing for integrating the latest insights into this comparative analysis.

Research Questions

Building upon the research objectives, this study is guided by the following questions with a particular emphasis on Indonesia:

1. How does ESG performance impact firm value specifically within the Indonesian market context?
2. What regulatory, investor, and socioeconomic factors mediate the relationship between ESG performance and firm value in Indonesia?
3. Which dimensions of ESG—Environmental, Social, or Governance—demonstrate the most significant impact on firm valuation in Indonesia compared to developed markets?

This study's novelty lies in its explicit focus on Indonesia's emerging market context within a broader comparative analysis of ESG impacts on firm value across global markets (Eissa & Diab, 2024). By investigating how ESG criteria operate within Indonesia's unique regulatory and investor landscape, this research contributes fresh insights to the literature on ESG performance in emerging markets (Gherghina, 2024; Tang & Zhang, 2022). Furthermore, the study provides a framework for policymakers and investors in Indonesia to tailor their ESG strategies, enhancing the effectiveness of corporate governance initiatives and aligning more closely with global standards. This research contributes to a nuanced understanding of ESG's role in corporate

valuation, equipping investors and regulators with market-specific insights to inform more effective ESG adoption strategies across diverse economic settings.

METHOD

Structured Literature Review (SLR) on ESG Performance and Firm Value

To systematically investigate the relationship between Environmental, Social, and Governance (ESG) performance and firm value across emerging and developed markets, this study applies a Structured Literature Review (SLR). The SLR method allows for a meticulous and unbiased survey of existing literature on this topic, employing a rigorous selection process for identifying, screening, and synthesizing relevant studies. This methodological approach adheres to established SLR guidelines (Tranfield, Denyer, & Smart, 2003) and is increasingly used to bring precision, transparency, and comprehensiveness to literature reviews, especially in fields that deal with rapidly evolving topics, such as ESG and firm valuation.

Steps in SLR Methodology

1. **Identification:** A comprehensive search is conducted across multiple academic databases, including Google Scholar, Scopus, Web of Science, and other relevant repositories. Keywords such as "ESG performance," "firm value," "corporate social responsibility (CSR)," "emerging markets," and "developed markets" are used to ensure coverage of all pertinent studies published in the last five years.
2. **Screening:** The studies are filtered based on the inclusion and exclusion criteria, which focus on publication in peer-reviewed journals, empirical analysis of ESG and firm valuation, and studies within the last five years (2019–2024). Duplicate records and studies outside the scope of the relationship between ESG and firm value are excluded.
3. **Data Extraction and Synthesis:** The selected studies are systematically analyzed to extract key findings, methodologies, and theoretical frameworks. The impact of ESG on firm value in emerging and developed markets is compared. This stage also involves identifying common trends, empirical gaps, and future research directions.

In the Data Extraction and Synthesis phase of this Structured Literature Review (SLR), selected studies are carefully analyzed to extract and organize key findings, methodologies, and theoretical frameworks related to ESG (Environmental, Social, and Governance) performance and firm value across developed and emerging markets. The objective is to discern patterns in how ESG practices impact firm valuation and to reveal gaps in the current literature. Data Extraction: Each selected study's findings are extracted based on the following key themes:

- **ESG Dimensions and Impact:** Specific aspects of ESG performance that influence firm value (such as environmental disclosures, corporate social responsibility, and governance practices).
- **Market Context:** Studies are categorized based on whether they focus on developed or emerging markets, as the impact of ESG factors can vary significantly across these contexts.
- **Methodology:** Different research methodologies, such as regression analysis, panel data analysis, and case studies, are recorded to evaluate the robustness and replicability of findings.
- **Outcome Measures:** Metrics such as firm value, stock performance, and financial performance are documented to understand the financial impact of ESG activities.

4. Ensuring data quality in a Structured Literature Review (SLR) on ESG performance and firm value involves multiple strategies to guarantee the findings' accuracy, reliability, and comprehensiveness. Here are the key steps to quality assurance:
 - Rigorous Screening and Selection Process
 - Inclusion and Exclusion Criteria: Set strict criteria to select only high-quality, peer-reviewed articles published in reputable journals
 - Over the last five years (2019–2024), ensure relevance and recent findings (Tranfield, Denyer, & Smart, 2003).
 - Cross-Database Search: Use multiple databases (e.g., Scopus, Web of Science, Google Scholar) to capture a comprehensive range of studies, minimizing the risk of missing relevant research (Gough et al., 2017).
 - Review Duplicates: Carefully check for and remove duplicates or near-duplicate studies, mainly if they appear across multiple databases, to avoid redundant data analysis.
5. Reliability of Data Extraction
 - Independent Reviewers: Use multiple reviewers during the data extraction phase to cross-check each study's extracted data for consistency and accuracy. This reduces individual bias and accurately captures data points (Kitchenham & Charters, 2007).
 - Pilot Testing the Extraction Form: Before completing data extraction, pilot test the data extraction form on a few studies to refine and ensure it captures all relevant variables, such as study methodology, sample size, and critical findings, relevant to ESG and firm valuation
6. Triangulation of Data
 - Methodological Triangulation: Compare findings from different research methods (e.g., quantitative vs. qualitative studies) to ensure diverse perspectives on ESG impact on firm value are considered (Patton, n.d.).
 - Cross-Market Validation: Contrast findings across emerging and developed markets to identify consistent patterns or unique insights in either context, enhancing the review's depth and robustness.
7. Quality Assessment of Studies
 - Critical Appraisal: Assess each study for quality using a structured appraisal tool, such as CASP (Critical Appraisal Skills Programme) checklists. Evaluation factors include research design, sample size, control for confounding variables, and study limitations (Higgins, 2011).
 - Relevance and Rigor: Examine the rigor of each study's methodology and the relevance of its findings to the research question. Studies with robust statistical analysis (e.g., panel data analysis or regression models) and relevant ESG metrics are prioritized.
 - Consistency in Variable Definition: Ensure consistency in measuring ESG and firm value across studies. Studies may use different metrics for ESG (e.g., environmental disclosures, governance ratings) and firm value (e.g., stock price, return on assets). Standardizing these variables allows for more accurate comparisons (Goyal et al., 2019).
 - Harmonized Coding: Develop a coding framework to categorize findings across dimensions like ESG metrics and market context, which allows for consistent analysis and avoids subjective interpretations.
 - Source Credibility: Prioritize data from high-impact journals and reputable sources to ensure the reliability of study findings.
 - Citation Verification: Check key studies' citation history and impact to validate their relevance and acceptance in the academic community.
8. Comprehensive Reporting and Transparency

- **Documenting the Review Process:** Clearly document each step of the SLR process, from search strategy to inclusion/exclusion criteria and data extraction methodology. This transparency enhances the review's replicability and allows future researchers to validate or expand upon the findings.
- **Report Limitations:** Acknowledge limitations in data quality, such as publication bias or gaps in regional data, which may affect the generalizability of the results. Transparently reporting these limitations supports more nuanced interpretations (Aguinis et al., 2021).

This structured quality assurance process bolsters the integrity and reliability of findings in the SLR on ESG performance and firm value, providing a robust basis for interpretation and future research directions. Insights and trends are reported to illustrate the contrasting or converging effects of ESG performance on firm value across different market contexts (Aziz & Alshdaifat, 2024; Minzhen, 2023). The SLR synthesizes findings on how market development influences the impact of ESG on firm valuation, focusing on both empirical evidence and theoretical contributions. The Preferred Reporting Items for Systematic Reviews and Meta-Analyses (PRISMA) guidelines provide a structured approach to performing systematic literature reviews, ensuring transparency, replicability, and rigor. For this study, PRISMA is used to guide the identification, screening, and selection of studies on the relationship between ESG performance and firm value in developed and emerging markets.

RESULT AND DISCUSSION

The Structured Literature Review (SLR) provides a nuanced understanding of how ESG (Environmental, Social, and Governance) performance impacts firm value within Indonesia. It highlights how Indonesia's unique regulatory, investor, and socio-cultural landscape shapes the ESG-firm value relationship. These findings reveal significant differences in the impact of ESG factors between Indonesia and developed markets.

1. **How Does ESG Performance Influence Firm Value in Indonesia Compared to Other Markets?**
 - **Positive but Inconsistent Impact:** In Indonesia, ESG performance has a generally positive effect on firm value, but this impact is less consistent and more sector-dependent than in developed markets. Firms in high-profile sectors such as mining, agriculture, and energy—which face substantial scrutiny from international investors and NGOs—show more significant ESG-related gains. However, firms in sectors with lower environmental exposure, such as retail and services, experience limited valuation benefits from ESG initiatives, as domestic investor interest in ESG remains low and focused on immediate returns (Arifin, 2022).
 - **Comparison with Developed Markets:** ESG consistently contributes to firm value in developed markets due to stringent regulatory frameworks and investor expectations. For instance, ESG compliance is closely tied to long-term risk mitigation and corporate stability, which drives firm valuation. Conversely, in Indonesia, where ESG is still developing, investors see it as beneficial but not essential, leading to a weaker link between ESG and firm value.
2. **Contextual Factors Mediating the ESG-Firm Value Relationship in Indonesia**
 - **Regulatory Framework:**

- **Evolving Policies with Limited Enforcement:** Indonesia's regulatory environment for ESG is still developing, with partial enforcement that limits ESG's influence on firm valuation. Although the Financial Services Authority (OJK) encourages sustainable finance disclosures, these remain voluntary, and compliance is inconsistent. This incomplete regulatory support undermines investor confidence and creates gaps in ESG's valuation impact (OJK, 2021).
 - **Emerging Green Finance Initiatives:** Recent initiatives, such as green bonds and sustainability-linked loans, provide promising avenues for incentivizing ESG adoption. These financial products, aimed at attracting environmentally conscious investors, could potentially strengthen the link between ESG and firm value in Indonesia by rewarding firms committed to sustainability (Mahardika & Suryani, 2023).
 - **Investor Behavior:**
 - **Influence of Foreign Investors:** Foreign investors, especially those from markets with strong ESG norms, drive demand for ESG practices in Indonesia. These investors view ESG as critical for risk management, prompting Indonesian firms—particularly those with international exposure—to adopt more comprehensive ESG practices (Kusuma & Mulya, 2021). This external pressure is helping to embed ESG as a factor in firm value gradually.
 - **Limited ESG Interest Among Local Investors:** In contrast, domestic investors prioritize short-term financial returns, which leads to a weaker local response to ESG practices. Consequently, firms that cater primarily to local investors are less incentivized to adopt ESG measures, reducing the overall impact of ESG on firm valuation in Indonesia.
 - **Socioeconomic and Cultural Factors:**
 - **Cultural Emphasis on Social Responsibility:** Indonesian culture emphasizes community support and social responsibility, which boosts the valuation impact of social ESG initiatives. Social projects, such as community development and local employment, resonate with Indonesian investors and consumers, indirectly enhancing firm value. This differs from developed markets, where environmental and governance factors generally take precedence (Sari, 2020).
3. **Impact of ESG Dimensions on Firm Valuation in Indonesia**
- Governance (Highest Impact)**
- In Indonesia, the Governance dimension of ESG has the most substantial and most consistent impact on firm valuation, mainly due to governance's role in establishing corporate stability, transparency, and investor trust. Several factors specific to Indonesia's business and regulatory landscape amplify the importance of governance:
- **Corporate Stability and Risk Management:** Good governance is considered a critical indicator of corporate stability in Indonesia, where market volatility and regulatory inconsistencies can increase investment risks. Governance practices, such as well-structured boards, ethical leadership, and transparent decision-making, are perceived as essential for minimizing risks associated with political and economic fluctuations. Studies indicate that firms with strong governance structures are perceived as more resilient to market shocks, making them attractive to domestic and international investors (Sukmana, 2021).

- **Transparency and Investor Confidence:** Effective governance is crucial in enhancing transparency, which is especially valued by foreign investors operating in Indonesia. International investors often face challenges assessing the quality of information due to inconsistent reporting standards and limited disclosure practices. By demonstrating strong governance, firms can improve transparency, building trust with foreign stakeholders. This transparency is essential for firms seeking to attract international capital or partnerships, as foreign investors tend to favor companies with clear governance structures and reliable reporting practices (Kusuma & Mulya, 2021).
- **Compliance and Legal Risk Reduction:** In Indonesia, regulatory requirements related to corporate governance are growing, but enforcement remains patchy. Firms that proactively adopt best governance practices—such as compliance with anti-corruption policies, protection of shareholder rights, and regulatory adherence—are seen as less likely to encounter legal risks, which can be highly detrimental to firm value. Strong governance minimizes the risk of penalties or reputational damage associated with regulatory violations, which in turn helps maintain stable valuations (OJK, 2021).
- **Attraction of Foreign and Institutional Investors:** Governance practices are particularly valued by foreign and institutional investors, who are often hesitant to invest in markets where governance standards are perceived as weak. Given Indonesia's heavy reliance on foreign capital for economic growth, firms demonstrating robust governance are better positioned to attract long-term institutional investors. Such firms are often rewarded with higher valuations due to their perceived commitment to sustainable, ethical practices that align with global standards (Mahardika & Suryani, 2023).
- **Alignment with International ESG Standards:** As more Indonesian firms participate in international markets, aligning governance practices with global ESG standards (such as those set by the United Nations and other international organizations) has become increasingly important. Companies with governance practices that meet these standards are more likely to be included in ESG-focused investment portfolios, such as those of global mutual funds or ESG indices. This further enhances their valuation by increasing demand from socially responsible investors.

The Indonesian market's dependence on foreign investment and its evolving regulatory landscape further underscore the importance of governance in shaping corporate valuation.

In-Depth Analysis of ESG Performance and Firm Value in Indonesia Compared to Other Countries

The analysis of ESG (Environmental, Social, Governance) performance and its influence on firm value in Indonesia presents unique insights, reflecting broader trends in emerging markets while highlighting specific local dynamics. The Indonesian context reveals opportunities and challenges for integrating ESG into corporate valuation, shaped by regulatory development, investor behavior, and socio-cultural factors. This discussion contrasts these findings with those from other emerging and developed countries to explore how ESG dynamics differ based on market maturity and context.

ESG Performance and Firm Value: Indonesia vs. Emerging and Developed Markets

- **Developed Markets:** In developed economies like the United States and the European Union, ESG performance is firmly established as a critical determinant of firm value, driven by investor demand, regulatory standards, and market expectations. In these markets, strong ESG performance is consistently associated with enhanced firm valuation, as investors perceive it as a signal of stability, reduced risk, and long-term growth potential. Studies in these regions demonstrate that companies with high ESG scores tend to perform better financially, attracting capital from institutional investors with ESG mandates. For example, in the EU, ESG integration is heavily driven by regulations like the Non-Financial Reporting Directive, which mandates transparency in ESG reporting and is linked to improved investor confidence.
 - **Emerging Markets:** Emerging markets, such as Brazil, India, and South Africa, also see a positive impact of ESG on firm value, which is generally more variable than in developed economies. ESG is often tied to factors like industry pressures, foreign investment, and reputational considerations. In Brazil, for example, environmental concerns are paramount in sectors like mining and agriculture, where ESG compliance can significantly affect firm reputation and value. However, the regulatory frameworks in many emerging markets are still evolving, leading to inconsistency in ESG reporting and its impact on valuation (Wang & Sarkis, 2021).
 - **Indonesia's Unique Context:** as part of the emerging market group, Indonesia exhibits a positive but less consistent relationship between ESG performance and firm value. The impact of ESG practices is particularly notable in sectors with a high environmental footprint, such as mining, energy, and agriculture, where firms face local and international scrutiny. However, due to a lack of mandatory ESG reporting and the nascent stage of regulatory oversight, Indonesian companies are often selective in their ESG engagement, which affects the overall influence on firm valuation (Kusuma & Mulya, 2021). Compared to developed markets, where ESG is central to valuation, Indonesia's ESG-firm value relationship is still in a developmental stage and primarily influenced by the specific demands of foreign investors rather than uniform domestic expectations.
1. How does ESG performance influence firm value in emerging versus developed markets?
 - **Positive Impact in Developed Markets:** value. Studies indicate that firms with robust ESG practices often enjoy higher stock valuations, improved financial performance, and greater investor confidence (Alareeni & Hamdan, 2020; Belcaid, 2024). In these markets, ESG practices are seen as markers of reduced risk and corporate sustainability, contributing to long-term value creation.
 - **Mixed Impact in Emerging Markets:** The relationship between ESG performance and firm value in emerging markets is more varied. Some studies demonstrate a positive link, particularly in large and multinational firms that adopt ESG practices to appeal to international investors. However, other studies reveal that the impact of ESG on firm value can be neutral or even harmful in emerging markets, where local investor awareness and prioritization of ESG factors are often lower than in developed markets (Khan & Yadav, n.d.). This disparity is often attributed to varying levels of ESG integration, less mature regulatory frameworks, and inconsistent enforcement in emerging markets.
 - **Differences in Materiality:** ESG factors tend to be more material in developed markets, where institutional investors are highly attentive to ESG disclosures and may penalize companies with poor ESG performance (Li et al., n.d.). In contrast, they often carry less

weight in determining firm value due to less standardized reporting and weaker investor expectations.

2. What are the contextual factors (e.g., regulatory framework, investor behavior) mediate ESG-firm value relationships across these markets?

- Regulatory Frameworks:

- 1) Developed Markets: Stronger regulatory frameworks in developed markets ensure mandatory or well-established voluntary ESG disclosures, creating transparency and comparability among firms. For instance, in the EU, stringent ESG regulations such as the Non-Financial Reporting Directive (NFRD) compel firms to disclose ESG-related information, reinforcing investor confidence and linking ESG with higher firm value (Buallay, 2019).

- 2) Emerging Markets: Regulations in emerging markets are generally less comprehensive or inconsistently enforced, affecting the reliability of ESG disclosures and their impact on firm valuation. While some emerging markets are adopting ESG mandates, the lack of enforcement and resources can undermine the perceived value of ESG efforts among investors.

- Investor Behavior:

- 1) Institutional Investors in Developed Markets: factors, viewing them as indicators of risk management and corporate governance quality. Studies show that institutional investors reward firms with high ESG scores, often correlating with improved stock prices and valuations.

- 2) Retail and Institutional Investors in Emerging Markets: While interest in ESG factors is rising in emerging markets, retail and even some institutional investors are more focused on short-term returns than ESG practices. This may lead to a lower correlation between ESG scores and firm value in these regions (Khan & Yadav, 2022).

- Cultural and Socioeconomic Factors:

- 1) Cultural values and socioeconomic priorities may focus more on immediate economic benefits and less on sustainable practices, impacting investor response to ESG activities (Li & Patel, 2021). In contrast, developed markets often emphasize long-term sustainability, driven by higher social and environmental awareness among investors.

3. Which ESG dimensions (Environmental, Social, Governance) have the most significant impact on firm valuation in each market type?

- Developed Markets:

- 1) Governance: Governance is the most significant ESG dimension influencing firm value in developed markets. Investors in these markets highly value effective governance practices as they signal strong corporate oversight, risk management, and ethical leadership (Suto & Takehara, 2023).

- 2) Environmental: Environmental factors also have a notable impact, particularly in regions with strict environmental regulations. Investors in developed markets often reward firms that reduce environmental risk through sustainable practices, such as carbon reduction initiatives and energy efficiency (Boffo & Patalano, 2022).

- 3) Social: Social factors impact, though often secondary to governance and environmental dimensions. Social aspects such as employee welfare, community engagement, and diversity practices enhance brand value and customer loyalty, which can indirectly support firm valuation.
- Emerging Markets:
 - 1) Governance: Governance also plays a crucial role in emerging markets, as effective governance practices are stability and risk management indicators. However, governance in emerging markets often reflects the need for essential transparency and legal compliance rather than sophisticated ESG goals (Wang & Sarkis, 2021).
 - 2) Social: often more material than environmental ones. Studies show that local communities value firms that invest in social projects, such as local employment or educational initiatives, which can help enhance firm reputation and increase market support (Li & Patel, 2021).
 - 3) Environmental: Environmental factors typically have a lower impact on firm value in emerging markets than developed ones, mainly due to lower regulatory enforcement and investor prioritization. However, firms engaged in international trade may still prioritize environmental practices to meet global investor expectations (Luo & Tang, 2019).

Regulatory frameworks and investor behavior play critical mediating roles, shaping the degree to which ESG factors affect firm value. These findings suggest that tailored ESG strategies, reflective of specific market characteristics, may optimize ESG's impact on firm value.

Exhibits a distinctive relationship between environmental, social, and governance (ESG) performance and firm value, shaped by local regulatory conditions, investor behavior, and socio-economic challenges. Compared to developed markets, the Indonesian context presents unique findings on how ESG practices affect firm valuation. Here are the results addressing the influence of ESG, the contextual factors mediating this relationship, and the specific impact of ESG dimensions in Indonesia.

1. How does ESG performance influence firm value in Indonesia compared to emerging and developed markets?
 - Positive but Inconsistent Impact: ESG performance generally positively impacts firm value in Indonesia, but this effect is less consistent and often smaller compared to developed markets. While Indonesian firms with strong ESG practices, particularly in high-impact sectors like energy and mining, can achieve reputational gains and access to international capital, the financial returns from ESG practices remain uneven. Studies indicate that only firms with sustained ESG commitment over time tend to realize measurable value increases, primarily through enhanced market reputation and investor appeal.
 - Sector-Specific Variability: The impact of ESG on firm value in Indonesia varies by sector. Industries with significant environmental or social impact, such as agriculture, manufacturing, and natural resources, benefit more visibly from ESG adoption due to heightened scrutiny from both local and international stakeholders (Fauzi & Idris, 2020). In contrast, firms in sectors with less environmental exposure, like services, tend to see more minor impacts on valuation from ESG practices.

- **Comparison with Developed Markets:** Unlike developed markets, where ESG consistently correlates with firm value due to robust regulatory support and established investor expectations, Indonesia's emerging market status weakens ESG performance and firm value. Investors in developed markets view ESG as essential for risk management, while in Indonesia, it is still seen as an added, though not essential, factor for financial success.
2. What are the contextual factors (e.g., regulatory framework, investor behavior) mediating ESG-firm value relationships in Indonesia?

Regulatory Framework:

- **Developing ESG Policies:** Indonesia's regulatory landscape for ESG is in its formative stages. The Indonesian Financial Services Authority (OJK) has introduced guidelines on sustainable finance, encouraging firms to disclose ESG-related information, but enforcement remains inconsistent (OJK, 2021). This lack of stringent, mandatory ESG regulations weakens the impact of ESG on firm value, as firms are often only partially compliant with ESG practices, reducing investor confidence in the authenticity of reported ESG activities.
- **Emerging Green Finance Initiatives:** Recent green finance initiatives, including green bonds and sustainability-linked loans, show promise in strengthening the ESG-firm value link in Indonesia. These initiatives incentivize companies to adopt ESG practices to attract local and international investors interested in sustainability.

Investor Behavior:

- **Increasing Influence of Foreign Investors:** Foreign institutional investors, especially from markets with strong ESG norms, drive demand for ESG practices among Indonesian firms. These investors view ESG as a risk-mitigation tool, pressuring Indonesian companies to improve their ESG disclosures and adopt sustainable practices. This demand gradually increases ESG's influence on firm value, especially for firms that rely on international capital.
- **Local Investor Awareness:** Domestic investors in Indonesia, however, place less emphasis on ESG factors and are more focused on immediate financial returns. As a result, the local market response to ESG practices remains subdued, and firms are not uniformly rewarded for ESG performance, which limits its impact on firm valuation.

Socioeconomic and Cultural Factors:

- **Indonesia's cultural emphasis on social responsibility and community support** can drive firms to engage in social initiatives as part of their ESG activities. Socially oriented practices, like community development and local employment, often resonate with Indonesian consumers and investors, indirectly supporting firm value.
3. Which specific ESG dimensions (Environmental, Social, and Governance) impact firm valuation most in Indonesia?

Governance:

- **Strongest Impact on Firm Value:** Governance is the ESG dimension with the most substantial impact on firm value in Indonesia. Sound corporate governance practices—such

as transparent board structures, ethical leadership, and accountability—are highly valued by local and international investors, who see governance as essential for corporate stability. Studies highlight that firms with strong governance are perceived as lower risk, thus attracting more investment and achieving higher valuations (Sukmana et al., 2021).

Social:

- **Impact on Community and Brand Perception:** Social initiatives, such as local employment opportunities, community development, and employee welfare, also positively influence firm value in Indonesia, albeit to a lesser extent than governance. Due to the cultural importance of social contributions, companies that invest in social causes can enhance their reputation and customer loyalty, indirectly supporting firm valuation (Rahayu & Utami, 2020).
- **Relevance for High-Impact Industries:** Social factors play an especially prominent role in firm valuation.

Environmental:

- **Emerging but Limited Impact:** The environmental dimension of ESG has the least immediate impact on firm value in Indonesia, mainly because of the underdeveloped regulatory environment and lower awareness of environmental issues among domestic investors. While international stakeholders increasingly pressure firms in sectors such as mining and agriculture to manage environmental risks, domestic investors tend not to prioritize environmental factors as much as governance or social contributions (Wibowo, 2022).
- **International Influence:** Despite this, companies engaged in international trade or those reliant on foreign investment have started adopting environmental practices to meet international standards, which can boost their valuation in specific contexts, such as green financing or export-oriented businesses (Mahardika & Suryani, 2023).

In Indonesia, ESG performance positively affects firm value, but the impact varies across sectors and ESG dimensions. Governance practices have the most decisive impact on firm valuation, while social initiatives, reflecting cultural priorities, indirectly enhance firm value. Environmental factors are gaining importance due to international influences but remain secondary in the local investor context. A developing regulatory framework mediates the ESG-firm value relationship in Indonesia, the growing influence of foreign investors, and socio-cultural factors, suggesting that continued regulatory support and increased local awareness will be essential for strengthening the impact of ESG on firm valuation (Gül & Altuntaş, 2024). These findings highlight the complexity of ESG's influence on firm value in Indonesia, which is shaped by local conditions and growing international pressure.

In-Depth Analysis of ESG Performance and Firm Value in Indonesia Compared to Other Countries

The analysis of ESG (Environmental, Social, Governance) performance and its influence on firm value in Indonesia presents unique insights, reflecting broader trends in emerging markets while highlighting specific local dynamics. The Indonesian context reveals opportunities and challenges

for integrating ESG into corporate valuation, shaped by regulatory development, investor behavior, and socio-cultural factors. This discussion contrasts these findings with those from other emerging and developed countries to explore how ESG dynamics differ based on market maturity and context.

ESG Performance and Firm Value: Indonesia vs. Emerging and Developed Markets

- **Developed Markets:** In developed economies like the United States and the European Union, ESG performance is firmly established as a critical determinant of firm value, driven by investor demand, regulatory standards, and market expectations. In these markets, strong ESG performance is consistently associated with enhanced firm valuation, as investors perceive it as a signal of stability, reduced risk, and long-term growth potential. Studies in these regions demonstrate that companies with high ESG scores tend to perform better financially, attracting capital from institutional investors with ESG mandates. For example, in the EU, ESG integration is heavily driven by regulations like the Non-Financial Reporting Directive, which mandates transparency in ESG reporting and is linked to improved investor confidence.
- **Emerging Markets:** Emerging markets, such as Brazil, India, and South Africa, also see a positive impact of ESG on firm value, which is generally more variable than in developed economies. ESG is often tied to factors like industry pressures, foreign investment, and reputational considerations. In Brazil, for example, environmental concerns are paramount in sectors like mining and agriculture, where ESG compliance can significantly affect firm reputation and value. However, the regulatory frameworks in many emerging markets are still evolving, leading to inconsistency in ESG reporting and its impact on valuation.
- **Indonesia's Unique Context:** as part of the emerging market group, Indonesia exhibits a positive but less consistent relationship between ESG performance and firm value. The impact of ESG practices is particularly notable in sectors with a high environmental footprint, such as mining, energy, and agriculture, where firms face local and international scrutiny. However, due to a lack of mandatory ESG reporting and the nascent stage of regulatory oversight, Indonesian companies are often selective in their ESG engagement, which affects the overall influence on firm valuation (Kusuma & Mulya, 2021). Compared to developed markets, where ESG is central to valuation, Indonesia's ESG-firm value relationship is still in a developmental stage and primarily influenced by the specific demands of foreign investors rather than uniform domestic expectations.

CONCLUSION

Compared to developed markets, where ESG integration into corporate valuation is well-established, Indonesia remains in a formative stage of ESG adoption. The inconsistent regulatory framework, varying levels of local investor emphasis on ESG, and a reliance on foreign capital are significant mediators of the ESG-firm value relationship in Indonesia. To strengthen ESG's impact on firm valuation, regulatory bodies in Indonesia should implement mandatory and standardized ESG disclosure requirements and expand green finance incentives. Companies are encouraged to adopt robust governance and social initiatives to attract investor confidence while gradually integrating environmental practices to align with international standards. We would benefit from

enhanced awareness and understanding of ESG's long-term benefits to encourage broader market integration of these practices.

Recommendations

Several targeted recommendations are provided for regulatory bodies, companies, and investors to enhance the effectiveness and integration of ESG practices within Indonesia's corporate valuation landscape.

1. For Regulatory Bodies:

- **Implement Mandatory ESG Disclosure Standards:** Regulatory bodies such as Indonesia's Financial Services Authority (OJK) should mandate standardized ESG disclosures, ensuring companies. This would help increase transparency and investor confidence, especially among foreign stakeholders.
- **Strengthen Enforcement Mechanisms:** Robust enforcement mechanisms should be established to support mandatory disclosures. Regular audits and penalties for non-compliance would drive firms to adopt genuine ESG practices rather than merely symbolic actions.
- **Expand Green Finance Incentives:** The government should further develop and promote green financing options, such as green bonds, tax incentives, and subsidies for sustainable projects. These incentives can encourage firms to prioritize ESG initiatives while attracting capital from socially responsible investors.

2. For Companies:

- **Prioritize Strong Governance Practices:** Given the high-value investors place on governance, companies should focus on enhancing board transparency, ethical leadership, and accountability. Strengthening governance will mitigate risks and signal stability, making firms more attractive to local and international investors.
- **Develop Social Responsibility Initiatives:** Companies should invest in community-oriented projects, such as local employment, education, and health initiatives.

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