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The Impact of Environmental, Social, Governance (ESG) and Profitability on Firm Value Moderated by Firm Size

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ABSTRAK

This study aims to examine the influence of ESG and profitability on firm value. This research method uses a panel data regression model. This study uses panel data of energy sector companies listed on the Indonesia Stock Exchange (BI) during the period 2020-2024. The hypothesis of this study is that Environmental, Social, Governance (ESG) affects firm value. Profitability affects firm value. Firm size affects firm value. Firm size is able to moderate the relationship between Environmental, Social, Governance (ESG) and firm value. And also firm size is able to moderate the relationship between profitability and firm value. The results of this study are ESG and Profitability do not affect Firm Value and firm size cannot moderate the influence of ESG and Profitability on Firm Value.

Keyword : Environmental, Social, Governance (ESG); ; Profitability; Company Value; Company Size

INTRODUCTION

Research Background

In the last decade, corporate sustainability issues have become a major concern among academics, practitioners, regulators, and investors. The concept of Environmental, Social, and Governance (ESG) reflects a new paradigm in assessing corporate performance and sustainability, not only from a financial perspective but also from a non-financial perspective on environmental, social, and governance impacts. ESG is considered a framework that integrates sustainability values into business strategy to create long-term value for all stakeholders (Eccles et al., 2014; Friede et al., 2015).

In addition to ESG, profitability remains a key indicator in assessing corporate performance. The pecking order theory (Myers & Majluf, 1984) states that profitable companies tend to have stronger access to internal funding, allowing them to increase their value without relying on external funding. Profitability is also often considered a signal of a company's competitive strength and operational efficiency, which ultimately impacts market perception.

However, the relationship between ESG, profitability, and corporate value is not always linear or uniform. Firm size is thought to act as a moderating variable, either strengthening or weakening this influence. Conversely, smaller companies may experience resource constraints, making the impact of ESG and profitability on firm value less significant.

This phenomenon is increasingly relevant given the growing global pressure on sustainable business practices following the COVID-19 pandemic, with investors becoming increasingly sensitive to ESG issues as part of their risk mitigation and long-term value creation strategies (KPMG, 2022; MSCI, 2023). In Indonesia, mandatory sustainability reporting through POJK No. 51/POJK.03/2017 also encourages companies to be more transparent in disclosing their ESG performance.

However, previous empirical research has shown mixed results regarding the relationship between ESG, profitability, and firm value, particularly when considering the role of firm size as a moderator. Therefore, this study is crucial to empirically and systematically examine how ESG and profitability influence firm value, considering firm size as a moderating variable.

Formulation of the problem

Based on the background described above, the research questions are as follows:

1. Does ESG influences company value

2. Does Profitability influences company value

3. Does Company size moderates the effect of ESG on company value

4. Does Company size moderates the effect of profitability on company value

LITERATURE REVIEW

Environmental, Social, and Governance (ESG)

ESG is a concept encompassing three main aspects of sustainability: environmental, social, and corporate governance. According to Eccles et al. (2014), ESG is used as a framework to measure the extent to which a company integrates sustainability principles into its operations and strategies. The environmental dimension encompasses energy efficiency, emissions reduction, and waste management; the social dimension relates to workers' rights, occupational safety, and community involvement; and governance encompasses board structure, business ethics, and transparency.

Empirical studies show that sound ESG implementation can strengthen a company's image, increase stakeholder trust, and mitigate non-financial risks, ultimately increasing company value (Friede et al., 2015; Buallay, 2019). According to legitimacy theory (Suchman, 1995), ESG also helps companies gain social legitimacy and mitigate potential conflicts with regulators and the public.

Profitability

Profitability reflects a company's ability to generate profits from its operational activities. Ratios such as Return on Assets (ROA) and Return on Equity (ROE) are often used as key indicators. Signaling theory (Spence, 1973) states that high profitability is a positive signal for investors because it indicates efficient resource management and bright business prospects. Furthermore, the pecking order theory (Myers & Majluf, 1984) states that profitable companies are better able to finance their investments with internal funds, thereby minimizing the cost of capital and increasing company value.

Previous research (Rohmana & Fitria, 2021; Yusra & Endri, 2020) confirms that profitability has a significant influence on company value, although results may vary depending on the industry sector and company characteristics.

Company Values

Firm value is often measured using indicators such as Price to Book Value (PBV) or Tobin's Q, which reflect market perceptions of the value of a company's assets. According to the theory of the firm (Jensen & Meckling, 1976), high firm value indicates that the company has successfully maximized shareholder wealth. ESG and profitability are considered two important factors that can influence market perception, both directly and indirectly.

Firm Size as a Moderating Variable

Company size influences the extent to which ESG and profitability impact firm value. The resource-based view (Barney, 1991) states that larger companies have more resources to implement sustainability initiatives and exploit economies of scale. Furthermore, larger companies often receive more public and regulatory attention, so the impact of ESG and profitability on firm value can be stronger than that of smaller companies (Velte, 2017).

Research by Aouadi and Marsat (2018) shows that firm size moderates the relationship between ESG and firm value, with larger companies exhibiting a significantly more positive relationship than smaller companies. Similarly, Andayani et al. (2017) found that firm size strengthens the effect of profitability on firm value due to their ability to manage risk and increase efficiency.

RESEARCH RESULTS AND DISCUSSION

Data Analysis Results

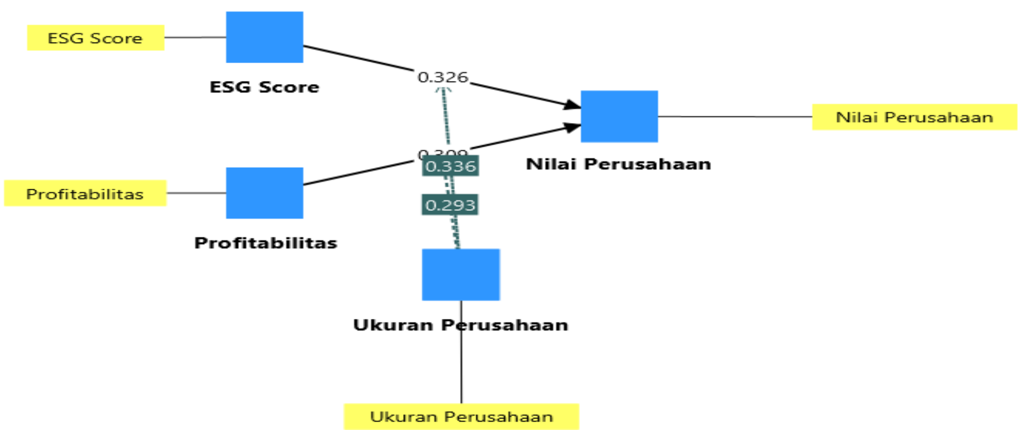
Descriptive Statistics

	Mean	Median	Observed min	Observed max	Standard deviation
ESG Score	39,093	25,000	2,000	230,000	38,398
Nilai Perusahaan	1,055	0,182	-17,034	180,471	8,985
Profitabilitas	0,217	0,036	-0,499	32,030	1,934
Ukuran Perusahaan	29,278	28,931	25,332	33,731	1,581

From the results above, we know:

1. For the ESG score variable, the sample size is 495. The mean is 39.093, with a standard deviation of 38.398, indicating a homogeneous distribution of the data because the standard deviation is lower than the mean.
2. For the firm value variable, the sample size is 495. The mean is 1.055, with a standard deviation of 8.985, indicating a heterogeneous distribution of the data because the standard deviation is higher than the mean.
3. For the profitability variable, the sample size is 495. The mean is 0.217, with a standard deviation of 1.934, indicating a heterogeneous distribution of the data because the standard deviation is higher than the mean.
4. For the firm size variable, the sample size is 495. The mean is 29.278. With a standard deviation of 1.581, this means that the level of data distribution is homogeneous because the standard deviation value is smaller than the average value.

Multiple Regression Analysis



Determination Coefficient Test

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	R-square	R-square adjusted
Nilai Perusahaan	0,017	0,007

Based on the table above, the R-square coefficient of determination test results are 0.017, or 1.7%. This indicates that the dependent variable, firm value, is influenced by the independent variables, namely ESG score, profitability, and firm size. Meanwhile, the remaining 98.3% (100% - 1.7%) can be explained by variables other than those studied.

Independent Variable (t-test)

Mean, STDEV, T values, p values					
	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics (|O/STDEV|)	P values
ESG Score -> Nilai Perusahaan	0,362	0,393	0,369	0,982	0,326
Profitabilitas -> Nilai Perusahaan	13,008	14,894	12,796	1,017	0,309
Ukuran Perusahaan -> Nilai Perusahaan	0,221	0,238	0,196	1,127	0,260
Ukuran Perusahaan x ESG Score -> Nilai Perusahaan	-0,011	-0,012	0,011	0,963	0,336
Ukuran Perusahaan x Profitabilitas -> Nilai Perusahaan	-0,521	-0,599	0,496	1,051	0,293

Based on the table above, the results of the t-statistic test for each independent variable against the dependent variable can be summarized as follows:

1. The ESG Score variable test results have a sig. value of 0.326, meaning (0.326 > 0.05). This indicates that the ESG Score does not significantly influence Company Value. It can be concluded that Hypothesis 1 (one) is rejected.

2. The Profitability variable test results have a sig. value of 0.309, meaning (0.309 > 0.05). This indicates that Company Size does not significantly influence Company Value. It can be concluded that Hypothesis 2 (two) is rejected.

3. The ESG Score variable test results moderated by Company Size has a sig. value of 0.336, meaning (0.336 > 0.05). This indicates that the ESG Score, moderated by Company Size, does not significantly influence Company Value. It can be concluded that Hypothesis 3 (three) is rejected.

4. The test results for the Profitability variable moderated by Company Size have a significant value of 0.293, meaning (0.293 > 0.05). This indicates that the ESG Score moderated by Company Size does not have a significant effect on Company Value. It can be concluded that hypothesis 4 (four) is rejected.

DISCUSSION

1. The Effect of ESG Scores on Company Value

The results of this study indicate that ESG has no impact on company value. This finding suggests that ESG implementation in energy sector companies in Indonesia during the 2020–2024 period has not significantly contributed to increasing company value (firm value). Investors tend to focus on short-term financial metrics, such as ROE or EPS, rather than long-term sustainability indicators. ESG implementation in Indonesia is still in its early stages of development, with many companies implementing ESG more to comply with regulations than as a long-term value-added strategy.

2. The Effect of Profitability on Company Value

The results of this study indicate that profitability has no effect on firm value, contradicting signaling theory, which states that more profitable companies are more trusted by investors and have higher market values. High earnings volatility in the energy sector makes investors more skeptical of current earnings as a projection of future value. External factors such as energy price fluctuations, government policies, and global uncertainty due to the COVID-19 pandemic can influence profitability on market value.

3. Company Size Moderates the Effect of ESG Scores on Company Value

The results of this study indicate that company size does not moderate the relationship between ESG and firm value. In theory, larger companies have greater resources to implement ESG more strategically and have greater market visibility. However, this study found no moderating effect of company size. ESG implementation in large companies has not yet had a direct impact on efficiency or profits; it is still at the image and reporting stage. Not all investors place greater weight on company size when assessing ESG effectiveness, especially if transparency and consistency in reporting are still low.

4. Company Size Moderates the Effect of Profitability on Company Value

The results of this study indicate that company size does not moderate the relationship between profitability and firm value. This finding suggests that both large and small companies face similar challenges in converting profitability into market value. This means that company size does not strengthen this relationship. The market values more than just profits and assets, such as governance, innovation, long-term strategy, and existential risk. Investors in the energy sector may be focusing more on sustainability indicators, operational efficiency, and long-term strategy than simply current size and profitability

Suggestion

Based on the research findings, the researchers offer the following recommendations:

1. Future research is recommended to use the ESG sub-pillars (environment, social, and governance) separately, rather than aggregated, to determine which dimensions are relevant.

2. Investors should not solely focus on company size, ESG scores, or profitability as determining factors when selecting stocks. Investors should consider other factors such as management quality and the company's long-term strategy.

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