

# ESG Disclosure and Market Capitalization: The Mediating Role of Firm Performance

Vina Alviana, Dewi Sriani\*, Niluh Putu Dian Rosalina Handayani Narsa

Department of Accounting Faculty of Economics and Business Airlangga University

Jl. Airlangga No 4 Surabaya Indonesia

Email: [alvianavinal1@gmail.com](mailto:alvianavinal1@gmail.com), \*[dewisriani@feb.unair.ac.id](mailto:dewisriani@feb.unair.ac.id), [niluh.narsa@feb.unair.ac.id](mailto:niluh.narsa@feb.unair.ac.id)

Correspondence Author Email: [dewisriani@feb.unair.ac.id](mailto:dewisriani@feb.unair.ac.id)

**Abstract**— This research aims to investigate the effect ESG Disclosure on market capitalization with firm performance as a mediating variable. The population in this study are LQ45 companies indexed in Indonesian Stock Exchange (IDX) in the period of 2017-2022 with 113 firm year observation as a final sample. The results show that ESG Disclosure has a negative effect on market capitalization, meanwhile ESG disclosure has no effect on firm performance. Firm performance has no effect on market capitalization. Therefore, firm performance can't mediate the relationship between ESG disclosure and market capitalization. The novelty of this study is using firm performance as intervening variable. The results provide practical insight to companies, investors and policy makers regarding the effect of ESG disclosure on market capitalization.

**Keywords:** ESG Disclosure, Firm performance, Market capitalization,

## 1. INTRODUCTION

In recent years, sustainable companies with little environmental effect have grown increasingly important in financial markets. Many firms utilize sustainable methodologies that integrate evaluation and application (Gavrilakis & Floros, 2023). Environmental, Social, and Governance (ESG) aspects. Environmental, Social, and Governance (ESG) Disclosure is one of the most critical factors influencing the public's and other stakeholders' perceptions of a corporation. However, ESG significantly limits investors' options because some companies perform well in terms of stock market price but engage in actions that are not approved by the ESG framework (Şerban et al., 2022).

Stakeholder theory addresses a number of interconnected concerns of how a corporation manages interactions with stakeholders. ESG disclosure is a significant component that determines investment levels, which, in turn, affects the company's value. Businesses compete to increase their usefulness and sustainability in terms of social, environmental, and governance for all stakeholders (Aulia Fadilah & Yuni Rosdiana, 2024). ESG disclosure is a significant component that determines investment levels, which, in turn, affects the company's value. According to signalling theory, companies that comply with corporate disclosure signal managerial quality to stakeholders (Veeravel et al., 2024). Companies that provide relevant information to potential investors might improve their reputation and attract more investments compared to their competitors.

Indonesian firms have yet to fully adopt ESG concepts in their business practices. The administration of ESG scores in Indonesia is relatively poor (F.Pam, 2021). The score is less than 30, and Malaysia, Singapore, and Thailand are all ahead of it. The Indonesia Stock Exchange created the ESG Leaders Index to encourage corporate adoption of ESG practices. The ESG Leaders Index evaluates a company's financial performance and commitment to incorporating ESG in its business processes, assisting investors in making informed investment decisions.

Previous studies found the mixed results regarding the effect of ESG disclosure on market capitalization. Kristek and Turjak (2023) found that higher ESG ratings were found to have a positive relationship with the company's market capitalization. From 2016 to 2020, this study examined a sample of 1,456 European Union enterprises. However, previous studies examined the effect of ESG Disclosure on market capitalization yield the mixed results. Using global sample from 78 countries, another studies conducted by Şerban et al., (2022) found that ESG Disclosure has a positive effect on market capitalization. Sugiarto et al., (2023) also found the similar results. Previous studies also found the positive impact of ESG on firm values (Siwei & Chalermkiat, 2023; Dkhili, 2024). However, Suttipun and Yordudom (2022) found that environmental and social disclosures had a positive impact on market reaction, meanwhile there is a negative impact of governance disclosure on market reaction. The inconsistent results lead to the other potential variable affecting this relationship.

The impact of ESG on firm performance were also investigated by previous studies Maji and Lohia (2023), Giannopoulos et al., (2022), N. et al., (2022) found that ESG has a positive effect on firm performance. Previous research also found that firm performance has a positive effect on market capitalization (Roosmawarni & Mauliddah, 2021). This study utilized firm performance as a mediating variable to better explain the relationship between ESG Disclosure and market capitalization. Accordingly, this study aims to investigate the effect of ESG disclosure on market capitalization by using firm performance as a mediating variable. The novelty is using firm performance as mediation variable that's not yet examined in the previous studies. Since ESG disclosure might

not have a direct impact on market value, it is crucial to test firm performance as a mediating variable between ESG disclosure and market capitalization. Rather, investors frequently assess whether ESG initiatives result in improved financial and operational performance. This study can determine whether ESG disclosure increases market capitalization directly or indirectly through better firm performance by taking firm performance into account as a mediating variable. This method lessens prejudice, fits in with theories like stakeholder theory, and gives managers and investors useful information about the true effects of ESG disclosure.

Since ESG disclosure by itself may not necessarily have a direct impact on market capitalization, firm performance can act as a mediating variable between ESG disclosure and market capitalization. Instead, the firm's performance is the first indicator of the advantages of ESG practices, which include improved risk management, increased operational efficiency, improved reputation, and higher stakeholder trust. Investors are more likely to react favorably when a company exhibits improved firm performance, growth potential, or general stability, therefore this boosts market confidence and enhances market capitalization. In this sense, firm performance serves as the mediating variable which the capital market converts the intangible value of ESG disclosure into observable results, which is increasing market capitalization. This research provides insight to the companies, investors and policy makers regarding the effect of ESG disclosure on market capitalization.

Sharma et al., (2022) discovered a positive relationship between ESG scores and market capitalization values among six GCC countries (Saudi Arabia, Bahrain, Kuwait, Qatar, Oman, and the UAE). Meanwhile, Sinha Ray and Goel (2023) research in India yielded opposing results. As a result, this study selected Indonesia as a sample to determine whether ESG disclosure affect market capitalization with firm performance as mediating variable, specifically in LQ45. LQ45 is an Indonesian stock index that includes 45 companies from the Indonesian stock market with strong liquidity, a substantial market capitalization, and good fundamentals (BEI, 2022). Companies in LQ45 share similar qualities, such as high fundamental value and market capitalization value. It is envisaged that these traits are unique to be investigated as it is related to the effect of ESG to market capitalization, and this companies are also required to implement ESG reporting. Based on the previously indicated major developments in ESG reporting, this study used 2017-2021 as the research period. The time chosen is the years after the introduction of POJK Number 51/POJK.03/2017, which governs the requirement of sustainability finance among Indonesian companies.

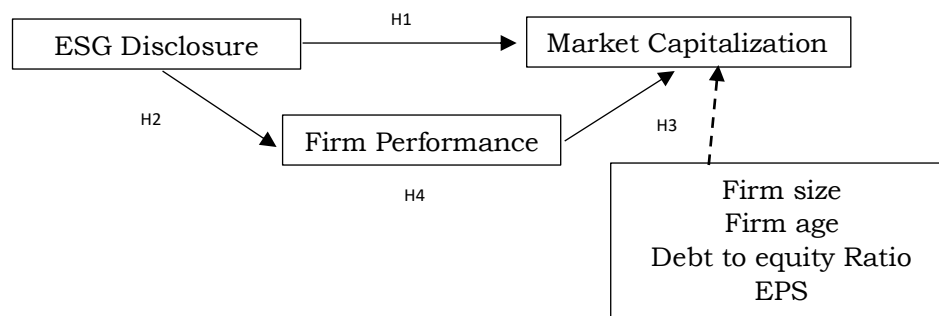
## 2. RESEARCH METHODS

The population in this study are LQ45 companies indexed in Indonesian Stock Exchange (IDX) in the period of 2017-2022 with 113 firm year observation as a final sample. This study focuses on LQ45 since it contains the most liquid shares with a high market capitalization. This study will provide a comprehensive picture of how ESG impacts major and influential enterprises in the Indonesian market. Institutional and individual investors frequently focus their attention on LQ45 stocks. This research will give investors with useful information for making investment decisions based on the ESG performance of prominent firms.

**Table 2.1.** Sample

Sample	Total
Non financial firms indexed in LQ45 2017-2022	178
Firms did not publish <i>Sustainability Report</i>	(48)
<i>Outlier</i>	(15)
Total	113

This study's population consists of companies that meet specific requirements for membership in the LQ45 index between 2017 and 2022. This study used purposive sampling with 2 criteria: first, non-financial firms indexed in LQ45 in the period of 2017-2022. Second, companies published the sustainability report. After elimination process based on sample criteria and eliminating outliers, hence the final sample was 113 firm year observation. This study relies on secondary data from two sources: the Sustainability Report and the OSIRIS database. ESG disclosure data derived from sustainability reports. The firm performance and control variables are gathered using the OSIRIS database. The conceptual framework is depicted in figure 1 below. The first hypothesis is examined that ESG Disclosure has positive effect on market capitalization. Followed by H2 stated that ESG disclosure has a positive effect on Firm performance (H2). Then, H3 stated that firm performance has a positive effect on market capitalization, and the last the mediating role of firm performance, depicted in H4 stated that Firm performance mediates the relationship between ESG disclosure and market capitalization. This study utilized some control variables, for instance firm size, firm age, debt to equity ratio, as well as EPS.



**Figure 2.1.** Conceptual Framework

Based on the conceptual framework, the empirical model used in this research are as follow:

1.  $LNMC_{i,t+1} = \alpha_{i,t} + \beta_1 ESG_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 AGE_{i,t} + \beta_4 DER_{i,t} + \beta_5 EPS_{i,t} + \varepsilon$
2.  $ROA_{i,t} = \alpha_{i,t} + \beta_1 ESG_{i,t} + \varepsilon$
3.  $LNMC_{i,t+1} = \alpha_{i,t} + \beta_1 ROA_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 AGE_{i,t} + \beta_4 DER_{i,t} + \beta_5 EPS_{i,t} + \varepsilon$
4.  $LNMC_{i,t+1} = \alpha_{i,t} + \beta_1 ESG_{i,t} + \beta_2 ROA_{i,t} + \beta_3 SIZE_{i,t} + \beta_4 AGE_{i,t} + \beta_5 DER_{i,t} + \beta_6 EPS_{i,t} + \varepsilon$

## 2.1. The Measurement of Variable

### 2.1.1. ESG Disclosure

The ESG concepts form a framework system. Investors often use ESG to assess firm behavior and future competitiveness (Dkhili, 2024). Business enterprises now prioritize meeting the interests of all stakeholders, rather than just generating shareholder value. According to stakeholder theory, stakeholders desire to understand how firms' operations affect society (Siwei & Chalermkiat, 2023). As a result, in recent years, corporations have been publicizing their sustainability achievements through the release of ESG Disclosure (Maji & Lohia, 2023). The ESG disclosure (ESG) is calculated as the total items declared by the company divided by the total items specified by each GRI guideline (Harymawan et al., 2021). GRI was chosen because it is a regularly used metric in ESG, sustainability, and CSR research. During the research period, the GRI standards were updated twice, from GRI G4 to GRI Standards. As a result, the GRI guidelines used in the analysed sustainability reports differ. This change began in 2018, therefore most firms before 2018 were still using GRI G4, while most companies after 2018 were using the GRI standard, resulting in variations in the standards used to analyse company sustainability reports. GRI G4 contains 150 items for corporations to disclose. Unlike other guideline series, the GRI standard has two options: core and complete. The GRI standard includes 147 items. The overall number of items required to be revealed varies each organization, since they can choose the items that are most relevant to their current circumstances. The highest score a corporation can receive is 1, which is calculated by dividing the items revealed by the number of indicators required to be declared under the GRI standard. The ESG score is calculated by number of items stated by the company divided by number of items that must be disclosed (Harymawan et al., 2021).

### 2.1.2. Market Capitalization

The issue of company market valuation highlights the importance of investigating the influence of non-financial assessments of ESG reporting aspects (Gawęda & Złoty, 2023). Market capitalization (LNMC) is computed by multiplying the company's outstanding shares by its closing share price (Şerban et al., 2022). The closing share price is the closing share price on December 31 of the next year. To prevent extreme data imbalances, natural logarithm data conversion is performed on market capitalization data. According to signalling theory, ESG disclosure is information received by stakeholders as a signal that influences investment decisions, implying that disclosure this year will influence investment decisions next year. Wei et al., (2020) said that there is a time gap in study on sustainability reports and market capitalization. Time lag develops as a result of information received by investors about the company this year, which is then used to analyse investment decisions for the next year.

### 2.1.3. Firm Performance

Mediating variable are those that adjust the relationship between the independent and dependent variables. The mediating variable's influence can be described as an indirect relationship. In this study, the mediating variable is firm performance as measured by Return on Assets (ROA). ROA is computed by net income divided by total assets (Altahtamouni, 2024).

### 2.1.4. Control Variables

Control variables in this study are total assets (LnTA), EPS, leverage (LEV), and firm age. The measurements of control variables are based on (Rettob et al., 2021; Singla & Prakash, 2023). Total assets are computed by adding up all of the company's assets and using the natural logarithm (Rettob et al., 2021). When a company's assets grow,

its share price rises. Increased share prices will, of course, result in an increase in the company's market capitalization value. Accordingly, total assets have an influence on the company's market capitalization value.

Earnings Per Share is a market ratio that shows how much money can be made per share originated (Rettob et al., 2021). Earnings Per Share (EPS), a proxy for the market ratio, has a positive effect on share prices. An increase in market ratio value might be a favorable indication for investors, resulting in higher share prices. The rise in share prices will eventually effect the increase in the company's market capitalization value. Earnings per share may be computed using the following formula: Earnings Per Share (EPS) = Net income/ Number of Shares Outstanding (Singla & Prakash, 2023).

Investors consider firm performance, particularly leverage, when making investment decisions. Leverage is measured by debt-to-equity ratio (Rettob et al., 2021) . A company's age is a substantial positive driver for market capitalization, the dependent variable. A corporation that has been around for a long period has more stable financial performance. Investors typically search for organizations that have a track record of being reliable and profitable. As a result, the age of the company might influence its market capitalization value. Company age (AGE) is calculated from the research period minus the year the business (Singla & Prakash, 2023). The data analysis techniques used in this study is multiple linear analysis. The mediation effect is examined using Baron and Kenny (1986) who define a mediating variable when it influences the relationship between the independent and dependent variables.

### 3. RESULTS AND DISCUSSION

Based on table 3, indicate that hypothesis 1, which asserts that ESG disclosure has a positive influence on market capitalization, is rejected. This study used 10% significant level.

1. Based of table 4.7, the significance of the ESG disclosure is 0.068 (which is less than 10%), with a negative coefficient of -0.846. It means that ESG Disclosure has a negative effect on market capitalization. Hypothesis 1 stated that ESG disclosure has a positive effect on market capitalization, therefore based on findings H1 is rejected.
2. Hypothesis 2 is depicted in model 2 showed that the significance of the ESG disclosure is 0.823, and the coefficient value is 0.632, indicating that the ESG disclosure has no effect on the firm performance. Hypothesis 2 stated that ESG disclosure has a positive effect on firm performance, however the findings showed that there is no effect of ESG disclosure on firm performance. Therefore, H2 is rejected.
3. According to 3, the ROA variable has a significance value of 0.934 and a coefficient of 0.001, indicating that ROA has no effect on market capitalization. hypothesis 3 claims that firm performance has a positive effect on market capitalization, therefore H3 is rejected.
4. Table 4 showed the mediation test for firm performance in the relationship between ESG disclosure and market capitalization. The Hayes bootstrapping approach used to draw conclusions about the mediation effect by examining the confidence interval generated by the bootstrap findings. The BootLLCI and BootULCI ranges in which do not include zero (0), indicating a mediation effect exist. In this test, the indirect effect section's output for BootLLCI and BootULCI ranges include zero (0), so there is no mediation effect. Hypothesis 4 stated that firm performance mediates the relationship between ESG disclosure and market capitalization. Based on findings, therefore, H4 is rejected.

**Table 3.** Hypotesis Test

	<b>Model 1</b>	<b>Model 2</b>	<b>Model 3</b>	<b>Model 4</b>
ESG	-.846*	.632		-.847*
	-1.849	.224		-1.842
ROA			.001	.002
			.083	.115
DER	.001		.001	.001
	.451		.472	.460
EPS	.000		.000	.000
	-.381		-.350	-.386
AGE	-.002		-.003	-.002
	-.383		-.505	-.386
SIZE	.405***		.420***	.404***
	3.845		3.938	3.819

**Table 4.** Mediation Test

<i>Total effect of X on Y</i>						
<i>Effect</i>	<i>se</i>	<i>t</i>	<i>p</i>	LLCI	ULCI	<i>c_cs</i>
-,9957	,4774	-2,0857	,0393	-1,9416	-,0497	-,1942
<i>Direct effect of X on Y</i>						
-,9955	,4796	-2,0755	,0403	-1,9461	-,0450	-,1942
<i>Indirect effect(s) of X on Y:</i>						
	<i>Effect</i>	BootSE	BootLLCI		BootULCI	
ROA	-,0002	,0425	-,0679		,1120	

**The effect of ESG Disclosure on market capitalization**

Based on the findings of the research tests for the first hypothesis, it was discovered that ESG disclosure had a negative effect on market capitalization; hence, the first hypothesis, that ESG disclosure had a positive effect on market capitalization, is not accepted (H1 is rejected). An increase in the Environmental, Social, and Governance (ESG) disclosure score might lead to a decrease in market capitalization. When making decisions, investors examine not just the Environmental, Social, and Governance scores, but also the company's financial elements. The bad impact of ESG disclosure in market capitalization can be linked to firms overinvesting in ESG initiatives. Increasing ESG efforts necessitates additional company resources. When a company's total resources are fixed, reallocating them diverts resources from other business processes. Funds allocated for product development may be transferred to support staff diversity and environmental efforts. It can also be due to the behavior of investors who prioritize financial factors in determining the value or benefits of an organization; in fact, investors do not really prioritize sustainability reporting in determining the value attached to the company, as reflected by market capitalization. However, investors tend to buy and sell shares on a daily basis in order to maximize cash profits, without regard for the company's long-term viability.

The findings of the first hypothesis are consistent with the views of Truong (2024), who revealed that in the near term, investors perceive ESG reporting as ineffective and can result in a decrease in market value. This study analyzes 591 nonfinancial listed companies in Southeast Asia from 2010 to 2022 with 2,673 firm-year observations and found that ESG has a negative effect on firm value (Truong, 2024). This finding is also reinforced by Cheng and Huang (2024), who investigated the impact of ESG scores on stock performance using S&P 500-listed companies from June 2013 to May 2023. The results showed that ESG combined scores are inversely connected with stock performance as measured by its return. As organizations invest more, shareholders and investors may associate ESG improvements with increased costs, leading to poorer firm performance and higher risks (Cheng & Huang, 2024). This finding is also consistent with research conducted by Gawęda and Złoty (2023) that examines the influence of ESG performance on firm market performance as measured by the rate of return of commodity sector corporations listed on financial markets in European Union Member States. ESG disclosure by surveyed companies, as well as ESG score, had a negative impact on returns.

This finding is consistent with agency problem type I, which is supported by shareholder theory and shows that an agent may overinvest a company's resources in ESG strategies at the expense of shareholders' interests (Friedman, 1970; (Meckling, 1976). In this regard, the findings demonstrate that the real world is complex and difficult to comprehend; there may be more to the stakeholder theory tale than standard assumptions. Developing countries are far more resource-constrained than highly industrialized nations; nonetheless, stakeholder theory suggests that enterprises in these countries benefit from the value-creating processes associated with efficiently managing stakeholder interests (Harrison et al., 2015). According to Friedman (1970), a company's primary purpose is to increase profits and value for its shareholders. Whereas spending on environmental, social, and governance disclosure standards might operate as a barrier to corporations' ability to generate higher profits. Shareholders suffer when the corporation fails to maximize profits. As a result, this study concludes that costs outweigh long-term value creation.

This finding contradicts with the previous studies conducted by Serban et al. (2022); Kristek and Turjak (2023) who found that environmental, social, and governance (ESG) disclosures have a positive impact on market capitalization. Kristek and Turjak (2023) Investigate the relationship between market capitalization and environmental, social, and governance (ESG) ratings of European Union (EU) corporations. Using a sample of 1,456 corporations from 2016 to 2020, this analysis discovered a positive correlation between better ESG ratings and a company's market capitalization. Environmental, social, and governance issues positively impact company performance, particularly in developed countries. The ESG score assesses long-term success by taking into consideration environmental, social, and governance variables, as opposed to only financial performance in

accounting. Siwei and Chalermkiat (2023) examine the relationships for a sample of 94 Chinese firms with four-year observations in the GICS energy industry between 2018 and 2021. The results demonstrate that ESG is considerably positively associated with business value.

Firms in Indonesia are unable to increase their ESG score due to limited resources and shareholder reactions (Nareswari et al., 2023). There are some restrictions to ESG adoption at the business level. First, consider the budget and resources. creating ESG at the corporate level requires additional cash and resources, such as creating a standard that meets environmental standards or developing a CSR program. Second, the metrics and measurements for ESG are unclear. There are no clear standards, which makes it difficult for investors to evaluate the program. ESG data had temporal instability and a lack of information regarding the consideration or debates. Third, some business managers continue to have a short-term emphasis, making it difficult to prioritize the ESG program because not all stakeholders respond positively to the ESG program (Nareswari et al., 2023).

Accordingly the implication for the first result showing that ESG disclosure has a negative effect on market capitalization are, first, companies may need to rethink how they promote ESG activities. Inappropriate or excessive disclosure without demonstrating real added value might lead to bad opinions among investors. Second, The findings of this study may promote the development of more accurate and meaningful ESG performance measures for investors. Companies must focus on measurements that accurately reflect strong environmental, social, and governance performance. Ineffective ESG disclosure can harm a company's reputation, affecting its share price and market capitalization. Companies must demonstrate that their ESG activities have a positive, provable impact. In addition, regulators and standard-setters could require to assess and improve ESG disclosure requirements to guarantee that such reports give clear and trustworthy additional value to investors. Investors may be more cautious when evaluating companies based on their ESG disclosure. They are likely to focus on basic investigation and financial performance rather than just ESG reporting. Investors and company managers require training and education to better grasp the relevance of ESG and how good disclosure can influence company performance. This includes training firm management on how to compile thorough and transparent ESG reports.

### **The effect of ESG Disclosure on Firm Performance**

Based on the findings ESG disclosure doesn't have an effect on financial performance as measured by ROA. Accordingly, the second hypothesis, which asserts that ESG disclosure has a positive effect on firm performance, is rejected. This demonstrates that organizations with high ESG disclosure scores are not always capable of producing high firm performance. Similarly, a low ESG disclosure score does not predict low firm performance. As a result, we may conclude that an ESG score has no effect on a company's firm performance.

This result is consistent with Kalia and Aggarwal (2023) who investigates the impact of environmental, social, and governance (ESG) scores on the financial performance (FP) of 468 healthcare organizations in the fiscal year 2020. The findings suggest that engaging in ESG activities has a beneficial impact on the performance of healthcare organizations in developed economies; however, in emerging economies, this link is negative or insignificant. Gawęda and Złoty (2023) Investigate the impact of a business's ESG performance (proxied by Refinitiv's ESG scoring) on firm performance capture using rate of return of commodity sector corporations listed on financial markets in European Union Member States. The results demonstrate that ESG scoring had a negative impact on the rate of return, whereas the ESG component, which included E, S, and G scores, had no effect on the rate of return at all. Farooq (2015) describes the association between ESG disclosure and corporate performance in India. The study covers 2005–2010 in India. This study demonstrated that ESG disclosure has no meaningful influence on business performance in contexts with more information asymmetries. Given that information is less credible in situations with smaller information asymmetries, stock market participants may not value ESG disclosure. Shahrin et al.'s (2022) also found that partial ESG disclosures had no meaningful effect on a company's performance. ESG disclosure should be able to communicate all stakeholders' expectations and needs to the corporation as a kind of corporate responsibility for controlling its environmental impact and contribution. ESG disclosure can serve as a communication tool between stakeholders and firms about corporate social responsibility and corporate governance.

The implication of this result showing that ESG disclosure has no effect on firm performance are, first, Companies must reassess the allocation of resources for ESG disclosure. If the disclosure has no major impact on performance, the corporation may consider allocating these resources to areas with a greater impact. Second, companies can consider continuing to make ESG disclosures, but in a more efficient and focused manner, tailored to the demands of various stakeholders. Regulators and standards-setting agencies may need to consider the findings of this study when formulating more successful and pertinent ESG disclosure policies and standards. Companies and regulators need to increase education and awareness of the importance of ESG among investors and other stakeholders. Although ESG disclosure may not have a direct influence on company performance, ESG factors are nevertheless vital for long-term sustainability and risk management. The findings of this study may

motivate corporations to focus on ESG risk management rather than just transparency. Good risk management can help businesses be resilient and competitive in the long run. Understanding these practical consequences enables businesses to make better decisions about how they manage and promote their ESG activities, as well as ensure that their efforts deliver actual and meaningful value. This results contradict stakeholder theory, which states that if a corporation pays close attention to its connections with stakeholders, it will improve support for the company's sustainability, allowing it to generate a higher amount of profit.

These results contradict with the previous research. Veeravel et al., (2024) investigates the impact of ESG disclosure scores on company performance of companies listed on the National Stock Exchange (NSE). From 2010 to 2020, 167 firms were sampled for this study. This study uses overall ESG disclosure ratings as a proxy to assess the impact of sustainability disclosure on business performance (ROA). The study's findings indicate a positive association between ESG disclosure and firm performance. Maji and Lohia (2023), N. et al., (2022) found that ESG has a positive effect on firm performance. Maji and Lohia (2023) examine the effect of environmental, social, and governance (ESG) performance on the firm performance of 222 chosen Indian enterprises. The results show that ESG performance and its components are favorably related to company performance. On another hand, Agarwal et al., (2023) that found ESG disclosure has a negative effect on firm performance. Kengkathran (2018) found that there are positive and negative relationships between ESG disclosure and firm financial performance of energy companies in ASEAN. Companies must establish relationships or partnerships with all interested parties, often known as stakeholders, such as employees, the community, environmental associations, the government, and others, in order to conduct business. This cannot merely benefit stockholders or specific parties, but must involve all stakeholders. However, the findings of this study revealed that environmental, social, and governance disclosure cannot be identified as a factor influencing a company's firm performance level, particularly for LQ45 indexed enterprises.

### **The Effect of Firm Performance on Market Capitalization**

Based on the findings, it is concluded that firm performance projected by ROA has no effect on market capitalization, and thus the third hypothesis, stated that firm performance has a positive effect on market capitalization, is rejected. High firm performance may not always translate to large market capitalization. This finding is consistent with study by Awaluzi and Maharani (2022) who found that firm performance forecasted by ROA has no significant effect on market capitalization. This study used manufacturing sector companies listed on the Indonesia Stock Exchange in 2018-2020. This results contradicts with signaling theory, which argues that information acquired as a signal influences the decision-making process. A high ROA should be a positive indicator and encourage investors to invest. The outcomes of this research may arise since in making investment decisions, investors undoubtedly weigh various elements from the company. Market capitalization value swings are influenced by a variety of micro and macro elements.

According to signalling theory, companies that comply with corporate disclosure signal managerial quality to stakeholders (Veeravel et al., 2024). Companies that provide relevant information to potential investors might improve their reputation and attract more investments compared to their competitors. The signaling theory is particularly effective for organizations fighting for resources. Investors have a tendency to favor capital gains and focus on daily share buying and selling, ignoring the company's annual ability to produce profits.

This finding contradicts with the previous research Almunani (2018) and Al-Nimer (2017), which found that firm performance has a positive and significant effect on market capitalization. The practical implication of these findings is that businesses may need to reconsider the performance measures they prioritize. If ROA has no effect on market capitalization, the company can explore other indicators, such as Return on Equity (ROE), net profit, or revenue growth, which may be more important to investors. Investors may need to apply a wider range of assessment factors when making investment decisions, rather than relying solely on ROA. Combining various performance measurements can give a more complete picture of a company's health and future. Companies should also assess how they convey financial results to investors. Companies should highlight alternative measures that have a greater impact on market capitalization to increase investor interest. Companies may need to change their incentive policies. If ROA is not the key signal that the market values, incentive plans that focus on other, more relevant metrics may be more effective in achieving the intended results.

### **Firm performance mediates the relationship between ESG disclosure and market capitalization**

Based on the finding, the fourth hypothesis stated that firm performance mediates the relationship between ESG Disclosure and Market capitalization is rejected. Previous studies conducted by Ghazali's (2020) shows that partial disclosure of the impact of ESG Disclosure has little effect on firm firm performance. Disclosure often requires large costs, making it an obstacle for companies to maximize performance and increase profits. Firm performance has no substantial effect on market capitalization. Almunani (2018) and Putri et al. (2020), also found

that firm performance has an effect on market capitalization value but is not significant. This could be due to investors' predisposition to prioritize daily share buying and selling operations in order to generate financial gain; hence the annual firm performance level of a company is not given much consideration. These two findings demonstrate that firm performance cannot operate as a mediator between ESG disclosure and market capitalization.

The impact of ESG scores on market capitalization can be explained using signal theory. Signal theory suggests that vendors regularly communicate with purchasers to reduce information asymmetry and improve decision-making accuracy for both sides (Spence 2002). Companies that prioritize social responsibility (SR) can recruit ethical and productive personnel, as well as investors who respect Sustainability. Insufficient ESG disclosure can indicate irresponsible behavior and shortsighted senior management (Cheng & Huang, 2024).

The practical implications of these findings are that companies must ensure that they successfully communicate the beneficial impact of their ESG initiatives to stakeholders, including investors. It may be worthwhile to emphasize the long-term benefits of ESG that are not immediately evident in ROA. Companies may need to prioritize non-financial criteria that demonstrate the impact of ESG on market capitalization. These measures could include customer satisfaction, employee loyalty, and reputation ratings. Companies must also adopt more focused and measurable ESG policies, the impact of which may be quantified directly against market capitalization. The government and firms must also increase education and understanding among corporate management and investors about the relevance of ESG and how these activities might affect market capitalization in the long run, even if the impact is not immediately obvious in Return on Asset (ROA).

#### 4. CONCLUSION

This research show that ESG Disclosure has a negative effect on market capitalization. Therefore, it can be concluded that when the ESG score increases, market capitalization will decrease, and vice versa. Furthermore, Firm performance neither affects market capitalization nor acts as a mediating variable. ESG Disclosure decrease market capitalization and contradicts with stakeholder and signalling theory. The limitations of this study are the analysis does not take company size or industry specifics. The study relies entirely on aggregated ESG scores. Based on these limitations, the first recommendation is to look into how firm size and industry influence the results. Future studies could examine how firm size and industry affect the relationship between ESG disclosure and market capitalization. In order to more clearly assess which aspects of ESG disclosure impact market capitalization, the second recommendation is to examine the individual ESG disclosure. As the practical implication, companies may need to rethink how they promote ESG activities. Inappropriate or excessive disclosure without demonstrating real added value might lead to bad opinions among investors. companies must ensure that they successfully communicate the beneficial impact of ESG to stakeholders, including investors. It may be worthwhile to emphasize the long-term benefits of ESG that are not immediately evident in ROA. Regulators and standard-setters could require to assess and improve ESG disclosure requirements to guarantee that such reports give clear and trustworthy additional value to investors.

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