Sustainable Finance and Firm Performance: A Systematic Literature Review

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Abstract. Research examines eco-social-governance (ESG) factors and corporate financial performance through a systematic review of the literature (SLR) that consists of international and national publications from 2015 to 2025. According to the results of the analysis, adopting ESG practices is positively correlated with firm value and investment returns. There is a huge difference between developed and emerging markets, which is that developed markets tend to embed ESG in their cost of capital structure, while developing markets including Indonesia are more focused on regulatory compliance and reputation management. In Indonesia, social and governance aspects are shown to contribute positively to the firm value, whereas environmental factors may lead to short-term cost burdens affecting profitability. This research proposes the adoption of ESG as a core business strategy and the use of digital technology for greater transparency in order to prevent green-washing practices.

Keywords: Sustainable Finance, ESG, Financial Performance, Emerging Markets, Developed Markets, Indonesia.

1 Introduction

The evolution of ESG research and implementation reached a critical juncture between 2020 and 2024. This time was a phase of ongoing compulsory disclosure, a restating of the corporate mission using stakeholder capitalism since 2019, and the enhancement of sustainability consciousness spurred by the pandemic. The regulatory reforms have drastically transformed the ESG execution environment from voluntary reporting to well-organized compliance. The European Union, via its CSR Regulation, is demanding about 50,000 enterprises to file sustainability reports. On the other hand, the SEC in the United States set out new climate information disclosure rules for better environmental risk transparency of the issuers [1].

Sustainable finance broadly refers to a policy of factoring in environmental issues, social concerns, and effective corporate governance when making investment decisions. Besides, sustainable finance means taking a firm stand on the need for transition to a more sustainable economy also raising awareness of the social responsibilities of businesses [2].

Bright investors around the globe who are interested in the environment, social matters, and good governance (ESG) do not get tired, and the amount of money dedicated

L. Warlina and S. Luckyardi (eds.), *Proceedings of the 9th International Conference on Business, Economics, Social Sciences & Humanities – Economics, Business and Management Track (ICOBEST-EBM 2026)*,
Advances in Economics, Business and Management Research 397,
https://doi.org/10.2991/978-94-6239-752-1_28

to this kind of investment has escalated incredibly fast. Particularly in developed countries, total assets managed in sustainable investment instruments increased sharply from US$321 billion in 2018 to US$2.1 trillion in 2022. This rapid growth has also spread to emerging markets. Their managed assets grew almost seven times during the same years. However, these markets still hold less money in sustainable investments than developed markets [3].

The market is growing faster. Still, academics disagree about the money involved in sustainability. This debate is complicated. Academics and professionals face a main question. Can focusing on Environmental, Social, and Governance (ESG) principles make more money or will it cost more. A combined analysis of over 2,000 empirical studies reveals a generally positive relationship between ESG performance and financial outcomes, with companies with strong ESG scores demonstrating greater resilience in times of economic instability [2]. As an illustration, in the initial period of the COVID-19 pandemic, companies that demonstrated a robust approach to crisis management based on Environmental, Social, and Governance (ESG) principles managed to carve out a much more substantial increase in share value when compared to similar companies that did not have a similar ESG foundation [4].

Generalizing research findings from developed countries to developing countries, also known as Emerging Markets, often faces challenges stemming from structural disparities. These emerging markets face unique challenges, including underdeveloped regulatory systems, high levels of information asymmetry, and substantial reliance on extractive industries, which carry significant potential environmental risks. In specific market contexts such as Indonesia, India, and Brazil, the application of Environmental, Social, and Governance (ESG) principles is often viewed more as a means to strengthen a company's image and comply with regulatory requirements, rather than as a deliberate strategy to consistently reduce the cost of capital [5]. The behavior of investors in emerging markets, who tend to prioritize profit generation in a shorter time period, can create potential conflicts with the characteristics of ESG (environmental, social, and governance) investments whose benefits tend to be realized over a longer time period [6].

In Indonesia, the Financial Services Sector Supervisory Agency, known as the Financial Services Authority (OJK), has proactively established a regulatory framework through the issuance of OJK Regulation No. 51/POJK.03/2017. This regulation specifically mandates the implementation of sustainable finance principles and requires every public company entity to submit a stand-alone sustainability report [7]. Despite an increase in the quantity of reports produced, issues regarding the quality and uniformity of the information disclosed still present significant obstacles. Several studies conducted in local markets have produced contradictory findings; some indicate that Environmental, Social, and Governance (ESG) practices contribute to increased corporate valuations due to growing stakeholder confidence [8]. Meanwhile, other studies focusing on the mining industry have revealed indications that increases in Environmental, Social, and Governance (ESG) scores do not automatically correlate with spikes in company profitability or increases in stock value over short periods of time [9].

This research focuses on a comprehensive synthesis of recent studies investigating the correlation between Environmental, Social, and Governance (ESG) factors and financial performance, with close attention to cross-country comparative analysis. Through a thorough examination of the mechanisms underlying the performance differences between developed and emerging markets, the study aims to detail the various situational elements that influence the extent to which the implementation of sustainable finance principles can have a financial impact. This research framework is carefully designed to provide valuable insights for academics, investment practitioners, and policymakers to facilitate the formulation of a more consistent and effective future framework for promoting sustainability practices at the global corporate level.

2 Literature Review

2.1 Theoretical Foundation for ESG Integration

Environmental, social, and governance (ESG) principles in the corporate financial management are backed by a solid theoretical framework that clearly delineates the concept and the process by which sustainable practices result in the firm's improved economic performance. The conceptual framework provided by these theories allows for a more comprehensive understanding of the complex interconnections between non-financial initiatives and the achievement of financial results.

2.2 Stakeholder Theory

Companies are able to generate long-term sustainable value by implementing management that takes into account the aspirations of all stakeholders, including consideration of the natural environment and the social needs of the community. This approach will ultimately contribute to increased levels of loyalty from various parties and simultaneously reduce the potential for disputes [10].

2.3 Signaling Theory

Reporting on Environmental, Social, and Governance (ESG) factors serves as a key indicator of an entity's leadership quality and predicts future performance for investors. This contributes to narrowing the information gap and ultimately lowering financing costs [6].

2.4 Legitimacy Theory

Carrying out responsible and sustainable operational activities is a crucial step for a business entity to ensure its compliance with prevailing norms in society, as well as an effort to gain the necessary approval or "social license" [6].

2.5 Resource-Based View

Environmental, Social and Governance (ESG) practices are recognized as an intangible asset resource, just like a strong corporate reputation, a positive organizational culture, and sustainable innovation capabilities, which collectively contribute to the creation of a competitive advantage that is very difficult for competitors to imitate or match in the market [2].

2.6 Agency Theory

The potential for conflicts of interest needs to be emphasized, because investment in Environmental, Social, and Governance (ESG) aspects can be considered a form of managerial "agency costs" if company management decides to allocate resources excessively, which is actually more directed towards fulfilling personal interests or merely image-building efforts [11].

2.7 Institutional Theory

This study outlines the mechanisms by which various external agents, including country-level legislation, public demand, and industry-wide norms, provide conclusive impetus for companies to integrate ESG-oriented practices [5].

Stakeholder theory continues to be recognized as a fundamental and widely adopted conceptual framework. At the heart of this theory is the view that the financial success of a business entity cannot be achieved independently of the attention and improvement of the well-being of all stakeholders [12]. The company proactively accommodates the needs of various stakeholders, including employees, consumers, and the wider community. These efforts contribute to the development of a positive image and solid trust, which has proven highly effective in providing protection and stability when the company faces challenges during periods of economic recession [2]. Unlike other approaches, the Agency Theory framework is often applied to justify empirical findings that show negative or neutral results. Funding allocated for community and ecological programs is seen as a deduction from the profits the shareholders are entitled to [11].

2.8 ESG Dimensions and Financial Performance

The ESG framework encompasses three fundamental pillars, each of which makes a unique contribution to an entity's financial performance. The environmental aspects of this framework emphasize implementing strategies to reduce emissions, increase energy efficiency, and develop environmentally friendly recycling and waste management methods [13]. Continuous integration of updates to this basic structure plays a role in reducing operational costs while reducing potential risks related to compliance with future legal standards [4]. The implementation of constructive social behavior in the workplace has been proven to substantially trigger an increase in employee work effectiveness while also fostering consumer loyalty [12]. A vital pillar of corporate governance, often referred to as the primary foundation, emphasizes the configuration of a competent board of directors. Implementing transparency in every workflow and safeguarding the interests of all shareholders [13]. The implementation of a robust and effective corporate governance mechanism is very important to minimize the possibility of corrupt practices within the company, while ensuring managerial accountability for every decision and action taken [2].

Empirical studies reveal inconsistent impacts of these three pillars across markets. Institutional investors in developed countries tend to view governance as the most crucial factor. Meanwhile, in emerging markets, environmental issues are often the primary focus, due to their correlation with potential operational risks in the heavy industry and extractive industries [14]. A meta-analysis has confirmed the existence of a significant correlation between governance components and economic performance. The study's results indicate that historically, the relationship between governance and finance has demonstrated greater stability and reliability than the relationship between environmental and social pillars [2].

2.9 Value creation Mechanisms Trough Sustaniable Finance

Implementing environmental, social, and governance (ESG) principles can generate financial benefits in various ways. Among other things, the most significant channels are operational efficiency improvement and innovation stimulation. Companies actively managing their assets efficiently tend to experience production cost decline and minimize risks of losses due to waste or material theft [4]. The most crucial factor second is the enhancement of competencies in risk management. By adopting environmental, social, and governance (ESG) practices proactively, corporations identify various threats such as risks related to climate transition, regulatory and legal challenges, and potential negative impacts on public perception, well before these issues become financial crises capable of significantly eroding the company's value [2].

The third impact of ESG integration is on a company's cost of capital. Companies with strong ESG performance are more likely to access funding at lower costs, as creditors perceive a lower risk of default. Furthermore, in equity financing, ESG disclosure can be a way to mitigate investor demand for higher returns to compensate for risk uncertainty, thus lowering the overall cost of equity capital [15]. Signaling theory is an excellent conceptual base for this method. It focuses on the fact that non-financial data is a kind of signal which helps the market to assess the true value of a business more accurately [6].

2.10 ESG Developments in Developed vs. Emerging Markets

The gap in institutional maturity between established and developing economies has resulted in a gap in the actualization of environmental, social, and governance (ESG) principles. In developed countries such as the United States, Germany, and Japan, robust regulatory frameworks, coupled with strong support from active shareholders, have motivated corporations to integrate ESG considerations into every stage of their strategic planning. In contrast, in developing markets such as India, Brazil, and South Africa, businesses often face significant challenges, including a lack of understanding of ESG issues, inconsistencies in existing policies, and limited short-term financial resources [5].

A substantial gap in understanding remains regarding the impact of emerging market "institutional voids" on ESG effectiveness. Based on the principles of Institutional Theory, the impact of ESG implementation is strongly influenced by the specific country environment. In environments where the legal system has a solid foundation, ESG-oriented practices tend to be more successful in delivering tangible and measurable financial contributions [14]. On the other hand, emerging research and data suggest that companies operating in emerging market contexts may experience greater marginal benefits from improvements in their ESG scores. The rationale is that a suboptimal starting position provides greater scope for image enhancement efforts and internal efficiency gains [16].

3 Methodology

This study uses a Systematic Literature Review (SLR) to map the impact of ESG integration on corporate financial performance. An extensive literature search was conducted in leading global databases (Scopus Q1/Q2, Web of Science, Emerald Insight) and SINTA (S1/S2) for the Indonesian context, covering publications from 2015 to early 2025. This time frame has been selected as a reflection of the post-SDGs shift and implications of the COVID-19 pandemic. The key terms that are used combine the concept of sustainable finance with financial performance parameters globally and domestically. To maintain the highest quality, every publication identified will go through a very strict screening procedure. The main requirements state that only original scientific works that have been peer-reviewed and are quantitative empiri will be considered. On the other hand, materials like editorials, personal opinions, or from dubious journals will be completely rejected in order to guarantee the validity of the overall findings.

4 Results

4.1 Aggregate Analysis of ESG Impact on Financial Performance

Research on systematic literature conducted over the last decade has consistently highlighted a positive relationship between the ESG aspects and financial performance of companies. A very comprehensive meta-analyses study, which involved over 1, 000 empirical publications, discovered that the majority of research (58%) reports a positive correlation with operational performance, in contrast to only 8% that indicate a negative relationship [4]. This is very much backed up by the fact that the company performance which includes sustainability at the core of its strategy is outperforming the ones that are ignoring the ESG aspects. Table 1 provides a summary of a number of studies that made investigations into the effects of ESG principles on the financial performance of firms. It organizes the studies into three different types.

Table 1. Results of the study on the impact of ESG on financial performance.

Study Type	Positive Results (%)	Neutral Results (%)	Mixed Results (%)	Negative Results (%)
Corporate Studies (ROA, ROE, Stock Price)	58%	13%	21%	8%
Investment Studies (Alpha, Sharpe Ratio)	59%	(including positive)	(including neutral)	14%
Low Carbon/Climate Studies	57%	29%	9%	6%

Overall, the majority of research findings more than 55% in all categories show a positive result, indicating that incorporating ESG aspects contributes to the increase in both the company value and the investment returns. Corporate studies (measuring ROA, ROE, share price) yielded 58% of positive results while 8% were negative. Investment studies (evaluating Alpha, Sharpe ratio) also recorded 59% of positive findings, with neutral and mixed results being categorized as positive/neutral, leaving 14% of negative results. Low-carbon/climate studies indicated a positive trend of 57%, with the dominance of neutral results (29%) and only 6% negative results. These results rebut the concern that sustainability compromises profitability because the financial gains are higher than the risks.

4.2 Comparing Developed and Developing Markets

One of the study's key contributions is that it investigated how the effects of investment guided by environmental, social, and governance (ESG) criteria differ in developed and emerging markets Initially, the findings from the base results indicated that only in two market groups there exists a positive linkage. Nevertheless, the level of institutional maturity is a crucial variable that not only affects the time series but also the importance of that relationship. Table 2 provides a clear comparison of the main aspects in which developed and developing countries differ regarding their mature ESG integration and strategic focus.

Table 2. Comparing developed and developing markets.

Characteristics	Developed Markets	Emerging Markets
Integration Maturity	Strategic and internalized in the capital cost structure.	Focus on compliance and reputation management.
Dominant Pillar	Social and Governance have a greater influence.	The environment is often more prominent and operationally relevant.
Disclosure Quality	High reporting standards and frequent external audits.	Fragmented, voluntary, and data quality varies widely.
Institutional Effectiveness	A strong legal system increases the effectiveness of ESG initiatives.	Institutional voids can limit the financial benefits of ESG.

Developed countries have used ESG elements as a strategic tool in their cost of capital structures, adding these considerations into the core of investment and operational decisions. On the other hand, developing countries' ESG adoption is still at the beginning stage and they mostly see ESG as a" necessary evil" in terms of complying with regulations and improving their image to the world and global capital markets. Apart from this, there is a great difference in which ESG pillars dominate and which operational direction lead. Developed countries are giving more weight to the social and governance pillars since well-functioning public institutions enable higher transparency, and also, to a large extent, social equality. At the same time, developing countries are concentrating their operations on the environmental pillar, which is a consequence of their exploitation of natural resources as well as their serious environmental degradation problem. The level of ESG reporting quality is also of a very different level. Developed countries have put in place very strict reporting norms, even going as far as external verification to guarantee the accuracy of data has been done. On the other hand, developing countries are still reporting in an irregular manner which is mostly on a voluntary basis, and this results in data of different quality which, in turn, makes it difficult for investors to do objective comparative analysis of company performance. The last facet touched upon is the way institutional effectiveness can lead to changed ESG results. That is good news for developed countries that have robust legal systems allowing them to turn their ESG efforts into quite substantial added value. As a result of the weak institutions and walls of legal uncertainty, however, developing countries have been restricted even in their ability to derive financial benefits from the implementation of sound ESG practices.

4.3 Indonesian Context-Specific Analysis

By examining scientific articles classified under SINTA 1 and 2, it has been revealed that the rise of ESG implementation in Indonesia. Besides, it was found that the awareness and reporting of environmental, social, and governance factors in Indonesia have significantly increased since the issuance of the OJK regulation POJK No. 51 of 2017 [7].

Impact on Profitability and Company Value. Variations in the impact of ESG aspects on financial performance in Indonesia are evident across industry sectors. In the energy and manufacturing sectors, ESG reporting has been shown to be directly related to ROA and firm value, driven by superior operational effectiveness and increased investor confidence [13]. The mining sector's phenomena demonstrate that substantial environmental management costs often weigh on short-term profitability. However, reporting on environmental issues remains fundamental to maintaining social legitimacy and facilitating investment in international capital markets [17].

An investigation into the Indonesian banking sector from 2010 to 2021 indicates that the combined disclosure of environmental, social, and governance (ESG) dimensions positively correlates with firm value. However, further in-depth analysis reveals that environmental exposures alone can negatively impact ROE and share price increases, indicating that regulatory compliance costs remain a significant burden for entities in the financial services sector. Conversely, disclosure of social issues and good governance principles tends to have a more pronounced positive effect on Tobin's Q, reflecting that stable stakeholder engagement and transparency in corporate governance are important considerations for local investors [18].

The Moderating Role of Governance and Profitability. In the Indonesian context, corporate governance principles play a significant role as moderating variables. Board attributes, including board size and the presence of independent commissioners, significantly contribute to improving the quality of environmental, social, and governance (ESG) disclosures [13]. The implications of Environmental, Social, and Governance (ESG) practices on a company's value also depend heavily on the entity's profitability. Investors tend to place greater value on ESG efforts undertaken by companies that have successfully built a stable and strong economic foundation. Meanwhile, in the context of companies experiencing financial difficulties or less profitable, ESG initiatives can potentially be interpreted as additional costs that will only burden the balance sheet [9].

Table 3. The Moderating Role of Governance and Profitability.

Variables	Impact on Financial Performance (Indonesia)	Main Mechanism
Combined ESG Score	Positive on Firm Value (Tobin's Q)	Increased legitimacy and investor confidence.
Environmental Pillars	Often Negative or Neutral to ROA/ROE	High initial investment burden and compliance costs.
Social Pillars	Positive towards Company Value	Improved reputation and relationships with the community.
Governance Pillars	Strong Positives on CFP and Risk Mitigation	Reduction of information asymmetry and agency costs.
Family Ownership	Weakening the ESG-Dividend relationship	Agency conflict between controlling and minority shareholders.

Table 3 is a comprehensive analysis of the effect of ESG on a company's financial performance in Indonesia. Combined ESG score and social contribution have been proven consistently to push the companies' valuation through legitimacy enhancement, investors' trust, and reputation, however, environmental aspects showed minimum or negative effects on ROA and ROE which is mainly brought about by high initial investment needs and compliance cost. On the other hand, the governance pillar significantly contributes to financial performance and risk mitigation by decreasing information asymmetry and agency costs. The analysis also points out the introduction of family ownership as a moderator in the relationship between ESG and dividend distribution, which is based on the potential agency conflict between majority and minority shareholders and also affects the sustainable strategy's effectiveness.

4.4 Global Moderating Factors: Technology, Culture, and Leadership

Recent research trends focus on examining non-financial components that act as moderating variables in the correlation between environmental, social, and governance (ESG) principles and corporate financial performance globally. Specifically, advances in digital technology, with artificial intelligence (AI) as an example, have been shown to contribute to improving information integrity and decision-making efficiency related to ESG issues, ultimately boosting the positive impact of ESG on a company's financial reputation [19]. In addition, the cultural attributes of a nation play an important role in shaping market dynamics, countries that prioritize a long-term view and have stronger risk aversion tools will generally show greater market acceptance of ESG information [20].

Leadership is a crucial dimension, with the concept of a "Green CEO" referring to an executive leader with a strong understanding and commitment to environmental issues, proven effective in accelerating the integration of environmental, social, and governance (ESG) principles into corporate systems. Consequently, companies led by such CEOs are able to achieve financial performance that exceeds that of companies with standard leadership approaches [21]. However, the availability of a strong leader is also essential. A longer-term CEO tenure can contribute to strengthening the positive impact of ESG issues on financial performance, particularly through the consistency demonstrated in the implementation of future-oriented strategies [22].

4.5 Challenges: Greenwashing and Rating Divergence

Many academic papers continue pointing out different significant hurdles in the implementation of the ESG ecosystem besides a few positive findings. One of the main problems discussed is the tendency to do "Greenwashing", which means companies making hardly credible sustainability initiatives to the public just for the sake of improving their image, without fundamentally changing the main operations. The desire to get accepted in developing countries with weaker regulations often becomes the reason for such behaviors [14]. Another significant issue is the inconsistency between ESG ranking methodologies. It is quite common for institutions such as MSCI, Refinitiv, and Sustainalytics to give very different ratings to the same companies. One of the main reasons for these discrepancies is the differences in methodology and weighting that these different agencies have adopted [23]. Such a huge difference in how assessment methods are being used is really causing the investors to be doubtful. As a result, there could be mistakes in capital allocation decisions. Research indicates that ESG rating agencies have a very low level of interdependence. This is a finding that strongly contrasts with the high predictability usually enjoyed by the conventional credit rating scores [24].

5 Conclusion and Recommendation

Sustainable finance that takes into account environmental, social and governance (ESG) factors essentially alters the financial performance of companies globally. Nevertheless, the impact is highly dependent on the institutional and geographical factors.

In developed countries, ESG is now considered a strategic value source, a method to reduce capital costs, and a means of innovation. Conversely, in a developing market such as Indonesia, ESG is still mainly focused on administrative compliance and is gradually shifting towards competitive differentiation. Such variations underscore the significance of regulatory readiness and the level of capital market maturity as moderating factors. Environmental issues in developing countries are mostly considered as a source of short-term costs but on the other hand, they can lead to long-term benefits, with good governance being the main support.

Furthermore, ESG acts as a buffer against financial losses during periods of economic volatility. Integrating ESG into their business transactions should be a priority for executives, rather than merely treating it as a philanthropic act, for better efficiency and risk management. The advancement of digital technology can further support the authentication of ESG reporting and reduce the chance of greenwashing.

Investors are encouraged to discover companies that are at the forefront of ESG practices since positive and consistent improvement in sustainability metrics is generally associated with higher profitability. Investors in emerging markets need to be very careful in evaluating governance quality as this would help them ascertain their environmental and social claims. Policymakers in Indonesia are expected to align reporting standards with international framework (ISSB, CSRD) and also to provide a platform for independent verification to build market confidence.

Future research should use long-term panel data to study the causal relationship between ESG and profitability, different sustainability data, ESG impact on specific sectors and SMEs, as well as their contribution to sustainable development goals (SDGs) and biodiversity. ESG is a reflection of the fundamental business evolution in which the synergy between financial profits and social value enhances the role of sustainable finance for global economic stability.

Acknowledgments. This research work could not have been completed without the help of many kind people. We thank Universitas Komputer Indonesia for providing the financial support that helped us cover the running costs of this project. Our sincere thanks also to the original researchers whose studies and writing we have quoted obtained through their pubications. In addition, the review panel members made several excellent suggestions that significantly improved the scolarly level as well as the effectiveness of this paper.

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