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From ESG Performance to Firm Value: Examining the Financial Consequences of Strategic Sustainability

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ABSTRACT: This study aims to analyze the effect of Environmental, Social, and Governance (ESG) performance on financial performance and firm value among energy-sector companies listed on the Indonesia Stock Exchange during the 2021–2024 period. The study employs a quantitative approach with a purposive sampling technique, yielding 66 energy-sector companies as the research sample and a total of 264 firm-year observations. The research variables consist of ESG as the independent variable, financial performance—proxied by Return on Assets (ROA)—as the mediating variable, and firm value—proxied by Price to Book Value (PBV)—as the dependent variable. Data analysis employs SmartPLS with a Partial Least Squares Structural Equation Modeling (PLS-SEM) approach. The results show that ESG has a negative and non-significant effect on financial performance. ESG, however, has a positive and significant effect on firm value. In addition, financial performance significantly mediates the effect of ESG on firm value, though the direction of this mediated relationship is negative.

Keywords: ESG; Financial Performance; Firm Value; PLS-SEM

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INTRODUCTION

Financial performance and firm value are two fundamental indicators used to evaluate a company's success in achieving sustainable business growth and enhancing shareholder wealth (Buallay, 2019; Velte, 2017). While financial performance reflects a firm's ability to generate profitability through efficient resource management (Xu & Liu, 2020), firm value represents investors' assessment of a company's prospects as reflected in market valuation, investor confidence, and corporate reputation (Khan et al., 2016). In modern capital markets, firm value is increasingly influenced not only by financial outcomes but also by a company's commitment to sustainable business practices and its ability to manage environmental, social, and governance (ESG) risks (Fatemi et al., 2018; Friede et al., 2015).

The growing emphasis on sustainable development has shifted corporate strategy from a traditional profit-maximization orientation toward long-term sustainability. Consequently, ESG has become an important indicator of corporate transparency, accountability, and competitiveness, while investors increasingly incorporate sustainability considerations into investment decisions (Eccles et al., 2014). In Indonesia, this trend is reinforced by regulations requiring listed companies to disclose sustainability information, indicating that ESG implementation has evolved from voluntary reporting into an integral component of corporate strategy.

Despite the growing importance of ESG, empirical evidence regarding its effect on financial performance and firm value remains inconclusive. Previous studies report both significant and insignificant relationships between ESG and financial performance (Al-Chalid & Septiani, 2024; Alareeni & Hamdan, 2020; Brogi & Lagasio, 2019; Prasetyo & Musmini, 2025; Velte, 2017; Setiawati & Hidayat, 2023; Wati & Werastuti, 2025; Wirajuna & Handajani, 2025), as well as between ESG and firm value (Brooks & Oikonomou, 2018; Melinda & Wardhani, 2020; Khan et al., 2016; Putu & Devi, 2024; Romli & Abdurohim, 2024). However, inconsistent findings alone do not sufficiently explain the mechanisms through which ESG creates corporate value.

This study argues that the relationship between ESG, financial performance, and firm value is particularly relevant in the Indonesian energy sector, where ESG implementation requires substantial investment in environmental technology, renewable energy transition, governance improvement, and social responsibility programs. Such investments may reduce short-term accounting profitability while simultaneously strengthening investor confidence and long-term market valuation. Accordingly, ESG may generate corporate value through different mechanisms operating over different time horizons rather than solely through improvements in financial performance.

Therefore, this study extends the existing ESG literature by explaining why ESG may fail to improve short-term profitability while still increasing firm value. This perspective provides a stronger theoretical explanation of ESG implementation in environmentally sensitive industries, where legitimacy and stakeholder confidence may develop more rapidly than operational efficiency. Using data from energy-sector companies listed on the Indonesia Stock Exchange during 2021–2024 and employing the PLS-SEM approach, this study examines both the direct and indirect effects of ESG on firm value through financial performance, thereby offering a more comprehensive understanding of how ESG creates corporate value in the Indonesian energy sector.

THEORETICAL REVIEW

Legitimacy Theory

Legitimacy theory holds that companies seek to obtain and maintain legitimacy from society by ensuring that their operational activities conform to prevailing social values, norms, and expectations. In the context of modern business, corporate legitimacy is determined not only by a firm's capacity to generate profit but also by its capacity to demonstrate responsibility toward environmental, social, and governance concerns. A company that meets stakeholder expectations through transparent sustainability disclosure gains social support, strengthens its reputation, and reinforces investor and public trust. Conversely, a company's failure to meet social expectations can produce a legitimacy gap, which may damage corporate image and depress firm value in the capital market. Rather than explaining improvements in internal operational outcomes, Legitimacy Theory primarily explains how ESG disclosure enhances external legitimacy by reducing information asymmetry, strengthening corporate reputation, and increasing investor confidence. In environmentally sensitive industries such as the energy sector, firms implementing ESG practices are more likely to obtain regulatory approval, social acceptance, and positive market recognition. Consequently, the benefits of legitimacy are expected to be reflected more immediately in firm value than in short-term accounting profitability (Deegan, 2019; Suchman, 1995).

Stakeholder Theory

Stakeholder theory holds that a company is accountable not only to its shareholders but to all parties with an interest in its activities—employees, consumers, creditors, government, the community, and the environment. The theory emphasizes that a firm's continuity depends heavily on its capacity to meet stakeholder expectations and needs. ESG disclosure functions as a channel of communication regarding a firm's commitment to responsible and sustainable business practices. By strengthening relationships with key stakeholders, ESG implementation may improve operational cooperation, reduce conflicts, enhance resource efficiency, and lower business risk. These improvements are expected to contribute primarily to financial performance through better operational effectiveness rather than directly through external legitimacy (Freeman, 1984; Freeman et al., 2010).

Firm Value

Firm value represents investors' perception of a company's success in managing resources and generating future profit prospects, as reflected in the company's share price in the capital market. Firm value is an important indicator because it reflects shareholder wealth and a firm's capacity to sustain its business over the long term. In modern finance, an increase in firm value is driven not only by financial performance but also by non-financial factors such as corporate reputation, governance quality, social responsibility, and sustainability practice. A company that demonstrates transparency, accountability, and commitment to sustainability tends to elicit a positive investor response, which in turn raises share price and market value. Firm value is thus commonly used as an indicator of a company's success in building investor trust and sustaining competitiveness in the capital market (Brigham & Houston, 2019; Ross et al., 2019).

Financial Performance

Financial performance describes a company's capacity to manage its resources effectively and efficiently in pursuit of its objectives, particularly the generation of profit, the maintenance of liquidity, and the enhancement of firm value. Financial performance reflects the degree of operational success a firm achieves within a given period, commonly measured through ratios of profitability, liquidity, solvency, and activity. In modern financial management, financial performance is an important indicator for investors, creditors, and management in assessing corporate stability, asset-use efficiency, and a firm's capacity to generate long-term profit. Beyond internal factors such as operational efficiency and capital structure, financial performance is also shaped by external and non-financial factors, including a firm's sustainability practice as expressed through ESG implementation. A company that implements sustainable business practice effectively tends to enjoy a stronger reputation, lower business risk, and greater investor trust, all of which support improved financial performance (Brigham & Ehrhardt, 2017; Gitman & Zutter, 2015).

Environmental, Social, and Governance (ESG)

Environmental, Social, and Governance (ESG) is a corporate sustainability concept that emphasizes the integration of environmental, social, and governance considerations into a firm's strategy and operations. ESG serves as an indicator of the extent to which a company conducts responsible and sustainable business practice over the long term. The environmental dimension concerns a firm's management of its operational impact on the environment, including emissions management, waste management, and energy efficiency. The social dimension encompasses a firm's relationships with employees, consumers, the community, and other stakeholders, while the governance dimension concerns transparency, accountability, oversight effectiveness, and the quality of corporate decision-making. In the perspective of modern capital markets, ESG implementation is regarded as capable of strengthening corporate reputation, reducing business risk, reinforcing investor trust, and generating sustainable firm value. ESG therefore functions not merely as a form of corporate social responsibility but as a corporate strategy for strengthening competitiveness and performance amid growing investor attention to sustainable business practice (Eccles et al., 2014; Friede et al., 2015).

Effectively implemented ESG is believed to enhance a firm's financial performance by improving operational efficiency, reducing business risk, and strengthening relationships with key stakeholders. According to Stakeholder Theory, firms that effectively respond to stakeholder expectations are more likely to obtain stakeholder support, customer loyalty, employee commitment, and stronger cooperation with investors and creditors. These benefits improve operational efficiency, reduce transaction and agency costs, and ultimately contribute to higher profitability (Freeman, 1984). Eccles et al. (2014) and Friede et al. (2015) find that companies with a high level of ESG implementation tend to exhibit stronger financial performance than companies with low ESG implementation. On this basis, the study proposes the following hypothesis:
H1: ESG has a positive effect on financial performance.

ESG is regarded as one of the strategic factors capable of enhancing firm value by strengthening reputation, transparency, and investor trust. From the perspective of Legitimacy Theory, ESG disclosure serves as a mechanism through which firms obtain social acceptance and market legitimacy by demonstrating accountability and transparency regarding environmental, social, and governance issues (Suchman, 1995). As legitimacy increases, information asymmetry declines, investor confidence strengthens, and the market responds more positively to the firm's long-term sustainability prospects. Consequently, ESG is expected to influence firm value more directly than short-term accounting profitability. Fatemi et al. (2018) find that ESG disclosure has a positive effect on firm value because it improves the quality of information available to investors. A similar finding is reported by Khan et al. (2016), who show that companies with sound ESG practice tend to command a higher market value than companies with weak ESG implementation. On this basis, the study proposes the following hypothesis:
H2: ESG has a positive effect on firm value.

ESG implementation may influence firm value through two simultaneous mechanisms. First, ESG disclosure strengthens corporate legitimacy and investor confidence, generating a direct positive effect on firm value through market valuation. Second, ESG implementation often requires substantial investment in environmental technology, governance systems, and social responsibility programs. These investments may temporarily reduce accounting profitability before long-term economic benefits are realized. Consequently, financial performance may transmit a negative indirect effect even when the direct market response to ESG remains positive. This coexistence reflects competitive (inconsistent) mediation, indicating that ESG creates corporate value through different mechanisms operating over different time horizons.
H3: ESG has a positive effect on firm value through financial performance as a mediating variable.

RESEARCH METHOD

Population and Sample

The population of this study comprises 92 energy-sector companies listed on the Indonesia Stock Exchange (IDX) through 2024. A purposive sampling technique was employed to select companies that (1) were consistently listed on the IDX during the 2021–2024 period, (2) published complete annual and sustainability reports, (3) disclosed ESG information required for calculating the ESG Disclosure Index, and (4) provided complete financial data for all research variables. Companies that did not meet these criteria were excluded from the sample. Based on these criteria, 66 companies were selected, resulting in a total of 264 firm-year observations over the

2021–2024 period. The sample represents various energy sub-industries, including coal, oil and gas, renewable energy, and energy-supporting services, thereby providing a comprehensive representation of Indonesia's energy sector.

Operationalization of Research Variables

The study variables are ESG, financial performance, and firm value. We measure the financial ratios as indicated in Table 1.

Table 1. Operationalization of Research Variables

Variable	Measurement	Reference
ESG	ESG Disclosure Index = Number of ESG items disclosed ÷ Total ESG items	(Eccles et al., 2014; Fatemi et al., 2018; GRI, 2021)
Financial Performance	Return on Assets (ROA)	(Brigham & Houston, 2019; Gitman & Zutter, 2015)
Firm Value	Price to Book Value (PBV)	(Brigham & Houston, 2019; Ross et al., 2019)

Source: Authors' Compilation (2026)

The ESG Disclosure Index was constructed using the Global Reporting Initiative (GRI, 2021) disclosure framework. Each ESG disclosure item was scored using a dichotomous approach, where a score of 1 was assigned if the company disclosed the item and 0 otherwise. The ESG score for each company was calculated as the ratio of the total disclosed ESG items to the total applicable disclosure items. Items that were not disclosed were treated as zero, consistent with the ESG disclosure index approach adopted by Eccles et al. (2014) and Fatemi et al. (2018).

Financial performance was measured using Return on Assets (ROA) because it reflects the efficiency with which companies utilize total assets to generate profits and is one of the most widely used profitability indicators in ESG research. Firm value was measured using Price to Book Value (PBV), as PBV captures investors' market valuation relative to the company's book value and is considered appropriate for examining market responses to ESG implementation. Although alternative measures such as Tobin's Q and Return on Equity (ROE) are frequently employed in previous studies, ROA and PBV were selected because they provide consistent accounting- and market-based measures that align with the objectives of this study.

Data Analysis Technique

This study employs Partial Least Squares Structural Equation Modeling (PLS-SEM) using SmartPLS rather than conventional panel-data regression because the primary objective is to examine both direct and indirect (mediating) relationships simultaneously within a single structural model. PLS-SEM is particularly appropriate for predictive analysis involving mediation effects and does not require multivariate normality assumptions, making it suitable for ESG disclosure data that often exhibit non-normal distributions (Hair et al., 2021).

Although this study utilizes panel data consisting of 264 firm-year observations, each firm-year observation is treated as an independent analytical unit following the pooled cross-sectional approach commonly adopted in PLS-SEM studies. Data analysis employs SmartPLS with a Partial Least Squares Structural Equation Modeling (PLS-SEM) approach to test both the direct and indirect effects among ESG, financial performance, and firm value.

The structural model was estimated using the bootstrapping procedure with 5,000 bootstrap subsamples to obtain standard errors, t-statistics, confidence intervals, and p-values for hypothesis testing. Statistical significance was determined at the 5% significance level ($p < 0.05$). The mediation analysis reports direct effects, indirect effects, and total effects to determine the type of mediation occurring in the model. Considering the coexistence of a positive direct effect and a negative indirect effect, the mediation pattern is interpreted as competitive (inconsistent) mediation, following the recommendations of Hair et al. (2021).

Hypothesis testing follows a bootstrapping procedure, evaluated through p-values; a hypothesis is accepted when the p-value is below 0.05 at the 5% significance level. The mediating effect of financial performance on the relationship between ESG and firm value is assessed through an indirect-effect test within the PLS-SEM model; the mediating effect is deemed significant when the p-value of the indirect relationship is below 0.05. Model evaluation includes assessment of the coefficient of determination (R^2), collinearity using the Variance Inflation Factor (VIF), path coefficients, effect significance, and mediation analysis to evaluate the structural relationships among the research variables (Ghozali & Latan, 2020; Hair et al., 2021).

RESULTS

Measurement Model

Descriptive analysis provides an overview of the characteristics of the research data for each variable—ESG, financial performance, and firm value—based on minimum, maximum, mean, and standard deviation values. The study consists of 264 firm-year observations from 66 energy-sector companies listed on the Indonesia Stock Exchange during the 2021–2024 period. Firm value shows a mean of 0.70, a standard deviation of 0.27, a minimum of 0.37, and a maximum of 1.03. Financial performance shows a mean of 1.79, a standard deviation of 2.35, a minimum of −3.24, and a maximum of 11.32. ESG shows a mean of 0.68, a standard deviation of 0.11, a minimum of 0.32, and a maximum of 0.95. These descriptive statistics indicate substantial variation in financial performance among firms, whereas ESG disclosure demonstrates relatively lower variability, suggesting a more homogeneous level of sustainability disclosure across the sampled companies.

The multicollinearity test examines whether the structural model exhibits excessive collinearity among predictor variables. Multicollinearity was assessed using the Variance Inflation Factor (VIF), where VIF values below the recommended threshold indicate that collinearity is unlikely to bias the estimated path coefficients (Hair et al., 2021). The multicollinearity test results indicate no multicollinearity among the variables, as all VIF values remain below the threshold of 3 (see Table 2).

Table 2. Multicollinearity Test Results

Variable Relationship	VIF	Remark
ESG → PBV	1.322	No multicollinearity
ESG → ROA	1.216	No multicollinearity
ESG → ROA → PBV	1.152	No multicollinearity

Source: Adapted Smartpls 4 Output (2026)

Coefficient of Determination

The coefficient of determination (R^2) measures the extent to which the model explains variation in the dependent variable. This study reports the adjusted R-square value in Table 3.

Table 3. Adjusted R-Square Values

Variable	Adjusted R-Square
Firm Value	0.831
Financial Performance	0.163

Source: Adapted Smartpls 4 Output (2026)

The adjusted R-square value for firm value is 0.831, indicating that ESG and financial performance jointly explain 83.1% of the variation in firm value, while the remaining 16.9% is explained by variables outside the model. According to commonly accepted PLS-SEM guidelines, this result indicates that the model has substantial explanatory power for firm value (Hair et al., 2021).

The adjusted R-square value for financial performance is 0.163, indicating that ESG explains 16.3% of the variation in financial performance, while 83.7% is attributable to other variables not included in the model, such as firm size, capital structure, operational efficiency, and macroeconomic conditions. This finding indicates that ESG contributes to explaining financial performance; however, a considerable proportion of the variation is determined by other factors beyond the scope of this study.

Hypothesis Testing

Hypothesis testing examines the direct and indirect effects among ESG, financial performance, and firm value. The results are presented in Table 4.

Table 4. Hypothesis Testing Results

Variable Relationship	Hypothesis	Effect	*t*-value	*p*-value	Decision
ESG → Financial Performance	H1	-0.507	-0.994	0.360	Rejected
ESG → Firm Value	H2	0.117	1.983	0.012	Accepted
ESG → Financial Performance → Firm Value	H3	-0.346	-3.062	0.002	Accepted
Total Effect		-0.229	-1.803	0.072	Not significant

Source: Adapted Smartpls 4 Output (2026)

The results indicate that the direct effect of ESG on financial performance (H1) is negative ($\beta = -0.507$) but statistically insignificant ($p = 0.360$), indicating that ESG implementation does not significantly improve the financial performance of energy companies during the observation period. Therefore, H1 is rejected. In contrast, ESG has a positive and statistically significant direct effect on firm value (H2) ($\beta = 0.117$; $p = 0.012$). This finding suggests that higher ESG disclosure enhances investors' confidence and market perception of a firm's long-term sustainability, resulting in higher firm value. Therefore, H2 is accepted.

The indirect effect of ESG on firm value through financial performance (H3) is negative but statistically significant ($\beta = -0.346$; $p = 0.002$), indicating that financial performance significantly mediates the relationship between ESG and firm value. Consequently, H3 is accepted. However, the mediation effect operates in a negative direction, implying that although ESG enhances firm value directly, it simultaneously reduces firm value indirectly through its adverse effect on short-term financial performance.

Furthermore, the total effect of ESG on firm value is negative ($\beta = -0.229$) but statistically insignificant ($p = 0.072$), indicating that the positive direct effect and the negative indirect effect offset one another. This pattern represents competitive (inconsistent) mediation, where the direct and indirect effects have opposite signs. The findings suggest that ESG creates corporate value through two different mechanisms operating over different time horizons. On the one hand, ESG disclosure strengthens corporate legitimacy, improves transparency, reduces information asymmetry, and enhances investor confidence, thereby generating an immediate positive response in market valuation. On the other hand, ESG implementation requires substantial investments in environmental initiatives, governance improvements, and social responsibility programs, which may temporarily increase operational costs and reduce accounting profitability. Consequently, the market appears to recognize the long-term benefits of ESG more rapidly than improvements in accounting-based financial performance. This finding provides empirical evidence that ESG influences firm value not only through financial performance but also through market-based legitimacy and investor expectations, supporting the argument that sustainability initiatives generate different economic consequences across short- and long-term horizons.

DISCUSSION

The hypothesis-testing results indicate that ESG has a negative and non-significant effect on financial performance among energy-sector companies. This finding suggests that ESG implementation in the energy sector has not yet produced a direct effect on firm profitability. This condition may stem from the energy sector’s characteristically high operating and environmental-compliance costs. Energy companies require substantial investment to adopt environmentally sound technology, manage carbon emissions, improve energy efficiency, and strengthen sustainable governance systems. These expenditures can raise a firm’s cost burden in the short run, thereby compressing profitability and depressing financial performance.

The energy sector is, in addition, highly sensitive to environmental issues and sustainability regulation. Pressure to meet ESG standards often requires companies to undertake operational transformation that demands substantial cost and time before its economic benefit materializes. ESG implementation in the energy sector therefore tends to yield long-term rather than short-term financial benefit, which explains why its effect on financial performance has not yet reached statistical significance over the study period.

Beyond the high implementation cost of ESG, the insignificant relationship may also indicate that sustainability initiatives require a longer period before generating measurable accounting returns. Improvements in environmental management, governance quality, and stakeholder relationships often produce intangible benefits, such as stronger organizational capabilities, enhanced corporate reputation, and lower long-term business risk, which are not immediately reflected in accounting profitability. Consistent with Stakeholder Theory, ESG implementation strengthens relationships with employees, customers, regulators, investors, and local communities; however, these benefits are more likely to emerge gradually rather than producing immediate financial gains. This finding suggests that ESG contributes more substantially to long-term organizational resilience than to short-term accounting performance.

Under stakeholder theory, an energy-sector company that implements ESG should secure legitimacy and stakeholder support through more environmentally and socially responsible business practice. This study's results indicate, however, that such support has not yet translated into a direct increase in profitability. This may occur because investors in the energy sector continue to weigh fundamental factors—global energy prices, production efficiency, and revenue stability—more heavily than ESG disclosure.

This finding is consistent with Wati and Werastuti (2025) and Wirajuna and Handajani (2025), who likewise find that ESG implementation has no effect on financial performance. It runs counter, however, to the findings of Alareeni and Hamdan (2020), Brogi and Lagasio (2019), Prasetyo and Musmini (2025), and Velte (2017), who find that ESG implementation enhances financial performance.

The hypothesis-testing results indicate that ESG has a positive and significant effect on firm value among energy-sector companies. This finding suggests that investors respond positively to energy-sector companies that implement sound ESG practice. In the energy sector, environmental issues attract particular attention because operational activity carries a direct environmental impact—carbon emissions, natural-resource extraction, and pollution among them. Energy companies that demonstrate commitment to environmental management, social responsibility, and sound governance therefore tend to secure greater trust from investors and the public.

ESG implementation in the energy sector is also seen as capable of reducing business and reputational risk. A company with strong ESG disclosure is regarded as better positioned to withstand environmental-regulatory pressure, shifts in energy policy, and global demands for a sustainable energy transition. This condition signals to investors that the firm has stronger long-term sustainability prospects, which in turn raises share price and firm value.

The significant positive effect also supports the central argument of Legitimacy Theory that firms adopting transparent sustainability practices are more likely to obtain social legitimacy and market acceptance. In environmentally sensitive industries such as the energy sector, ESG disclosure functions as a credible signal that the company is capable of managing environmental and regulatory risks while maintaining long-term sustainability. Consequently, investors appear to respond more strongly to the legitimacy and signaling value of ESG than to short-term accounting performance.

Under legitimacy theory, ESG disclosure represents a firm's effort to secure social legitimacy through transparency and accountability regarding its operations. An energy-sector company that meets public and regulatory expectations on sustainability secures a stronger corporate image and greater market trust. Under stakeholder theory, a company that meets stakeholder interests through sustainable business practice secures support from investors, consumers, government, and the community, which ultimately raises firm value. This finding is consistent with Brooks and Oikonomou (2018) and Melinda and Wardhani (2020), who find that ESG has a significant effect on firm value. It runs counter, however, to the findings of Jeanice and Kim (2023), Putu and Devi (2024), Romli and Abdurohim (2024), and Wangi and Aziz (2024), who find no effect of ESG on firm value.

These results indicate that ESG implementation in the energy sector significantly enhances firm value. This finding suggests that the capital market is beginning to place greater weight on sustainable business practice, particularly in a sector that carries substantial environmental risk. Energy companies should therefore pursue consistent improvement in the quality of their ESG implementation to strengthen investor trust and enhance firm value over the long term; furthermore, sustainability secures a stronger corporate image and greater market trust. Under stakeholder theory, a company that meets stakeholder interests through sustainable business practice secures support from investors, consumers, government, and the community, which ultimately raises firm value.

The hypothesis-testing results indicate that the indirect effect of ESG on firm value through financial performance is negative and significant. The negative mediating coefficient indicates that ESG implementation in the energy sector requires substantial investment, which depresses firm profitability in the short run. Energy-sector companies typically incur high expenditure to support ESG implementation—investment in low-emission technology, waste management, energy efficiency, the transition to renewable energy, and the strengthening of governance systems. This investment burden raises operating costs, compresses profit, and depresses financial performance. The resulting decline in profitability shapes investor perception of a firm's earnings capacity, which in turn exerts a negative effect on firm value through the financial-performance channel.

The study's results nonetheless indicate that the market continues to respond positively to ESG implementation directly, as shown in the preceding hypothesis test. This suggests that investors in the energy sector regard ESG as a long-term sustainability strategy capable of strengthening competitiveness and reducing future business risk. In the short run, however, the high cost of ESG implementation remains a factor that can compress financial performance. Under legitimacy theory, energy-sector companies implement ESG to secure social legitimacy and satisfy regulatory pressure related to environmental and sustainability concerns; the process of adjusting to sustainability standards, however, requires substantial cost that can reduce financial efficiency in the early stages of implementation. Under stakeholder theory, stakeholders support companies that demonstrate commitment to sustainability, but that support does not necessarily translate into an immediate increase in short-run profitability.

An important finding of this study is that the direct effect of ESG on firm value is positive, whereas the indirect effect through financial performance is negative. This pattern indicates competitive (inconsistent) mediation, suggesting that ESG simultaneously creates two different value-generation mechanisms. The first mechanism operates through corporate legitimacy and investor confidence, whereby ESG disclosure reduces information asymmetry, strengthens corporate reputation, and improves market valuation. The second mechanism operates through accounting performance, where substantial investments in environmental technology, renewable energy transition, governance improvements, and social responsibility programs temporarily increase operating costs and reduce profitability. Consequently, the positive market response to ESG is partially offset by its negative short-term effect on accounting-based financial performance.

These findings imply that the benefits of ESG emerge over different time horizons. Market participants appear to value sustainability initiatives immediately because they signal lower long-term business risk, stronger governance quality, and greater corporate legitimacy, whereas improvements in accounting profitability require a longer period to materialize. Therefore, ESG should not be evaluated solely on the basis of short-term financial performance, particularly in capital-intensive industries such as the energy sector.

The findings also provide important theoretical implications for both Legitimacy Theory and Stakeholder Theory. Consistent with Legitimacy Theory, ESG disclosure enhances firm value by strengthening corporate legitimacy, transparency, and investor confidence. Meanwhile, the insignificant relationship between ESG and financial performance suggests that Stakeholder Theory should be interpreted from a longer-term perspective, in which stakeholder support contributes gradually to operational performance rather than generating immediate profitability improvements. Furthermore, the identification of competitive (inconsistent) mediation extends the ESG literature by demonstrating that sustainability initiatives may simultaneously generate positive market valuation and negative short-term accounting consequences. This finding contributes to a more comprehensive understanding of how ESG creates corporate value in environmentally sensitive industries such as the energy sector.

CONCLUSION AND FURTHER STUDY

This study shows that ESG implementation affects financial performance and firm value through different pathways. ESG does not significantly improve financial performance, which suggests that the costs of energy transition, environmental management, governance improvement, and other sustainability investments have not yet translated into short-term profitability. ESG, however, significantly increases firm value. This finding indicates that investors recognize ESG as a signal of stronger corporate legitimacy, lower environmental and regulatory risk, and better long-term sustainability prospects. Financial performance also mediates the relationship between ESG and firm value in a negative direction, while the direct effect of ESG on firm value remains positive. This pattern confirms competitive or inconsistent mediation. ESG may therefore place temporary pressure on accounting performance while simultaneously strengthening investor confidence and market valuation. The findings extend Legitimacy Theory and Stakeholder Theory by showing that ESG can create corporate value through both financial and non-financial mechanisms that operate across different time horizons.

The findings also carry practical implications for managers and investors. Energy companies should integrate ESG into long-term corporate strategy rather than treat it only as a compliance or CSR obligation. Managers should improve the efficiency of ESG investments and connect sustainability initiatives with measurable operational and financial outcomes. Investors should consider ESG performance alongside conventional financial indicators because limited short-term profitability does not necessarily imply weak long-term value creation. This study is limited to publicly listed Indonesian energy companies during 2021–2024 and uses ROA and PBV as proxies for financial performance and firm value. Future studies should extend the observation period, compare industries, use alternative measures such as ROE and Tobin's Q, and examine additional mediating or moderating variables. Overall, ESG has not yet produced clear short-term financial gains in the Indonesian energy sector, but it has become an important source of firm value and long-term business sustainability.

ETHICAL DISCLOSURE

Not applicable.

CONFLICT OF INTERESTS

The authors declare no conflict of interest.

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