

ESG Performance and Firm Value: Evidence from the Indonesian Sharia Stock Index

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ABSTRACT:

This study analyzes the effect of Environmental, Social, and Governance (ESG) on firm value among companies listed in the Indonesia Sharia Stock Index (ISSI) during 2018–2023, both partially and simultaneously. ESG is relevant in Islamic investing as it aligns with the principles of justice, sustainability, and ethical business. Firm value is measured using Tobin's Q, while ESG is assessed through ESG Score, Environmental, Social, and Governance scores obtained from Bloomberg. The study employs panel data regression using the Random Effect Model, with size and leverage as control variables. The results show that both ESG Score and environmental performance have a significant negative effect on firm value, indicating that better ESG and environmental performance may reduce firm value. Social and governance scores have no significant impact. These findings suggest that ESG implementation in Indonesia remains suboptimal and does not yet reflect the Islamic economic principles of benefit and sustainability. Further research is needed to analyze companies that meet the Sharia Securities List (DES), compare firms with and without ESG practices, and examine specific sectors that may contribute most to the decline in firm value due to ESG. This is crucial for understanding ESG effectiveness in Indonesia's Islamic capital market.

Keywords: Environmental, Social, Governance, Firm Value, Islamic capital market, ISSI

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I. INTRODUCTION

The importance of the Islamic capital market aligns with the significance of companies that support such investments. This can be achieved by ensuring that corporate operations comply with Sharia principles, meaning that companies must not engage in activities that contradict Islamic teachings. Moreover, companies operating under Sharia guidelines are capable of enhancing societal welfare through their social and environmental responsibilities, contributing to community-based economic development. This is in line with (Hassan et al., 2022), who stated that Sharia-compliant companies also engage in sustainable and responsible practices, particularly in environmental dimensions, driven by Islamic business ethics that promote benefit for others.

In Indonesia, companies that meet the standards set by the Sharia Securities List of the Financial Services Authority (DES-OJK), indicating their compliance with Sharia principles, are included in the Indonesian Sharia Stock Index (ISSI). The number of companies listed in the Indonesian Sharia Stock Index (ISSI) has significantly increased, from 235 in 2011 to 599 in 2024, indicating a growing commitment to Sharia principles. This growth reflects companies' efforts to align with ethical, social, and environmental responsibilities, making ISSI-listed firms an ideal focus for research on sustainable and responsible business practices. Firm value, often measured using Tobin's Q (Zaleski, 2024; Tobin & Brainard, 1968), serves as a key indicator of performance, reflecting both market perception and alignment with ESG factors, which are central to Islamic economic values.

ESG is increasingly seen as a crucial benchmark for assessing company performance in line with Islamic principles. Studies such as Eccles et al. (2014) and Aydoğmuş et al. (2022) show that high ESG scores are linked to better firm value, while others like Atan et al. (2019) highlight inconsistent outcomes due to superficial implementation. In the Islamic context, ESG supports business ethics, justice, and social welfare (Qoyum et al., 2022), and integration of Islamic values with ESG—as supported by Bennett & Iqbal, 2013; Masih et al., 2018; and Moghul & Safar-Aly, 2015—enhances environmental and social awareness. However, ESG adoption in Indonesia remains relatively low, signaling the need for further investigation in this area.

The implementation of ESG in Indonesia still faces several challenges, primarily the limited number of companies consistently reporting their ESG performance. According to Bloomberg (2023), only 112 out of 1,005 listed companies (11%) in Indonesia reported ESG data, and from the 262 companies consistently included in the ISSI index between 2018 and 2023, only 30 regularly reported ESG performance. Key obstacles include the lack of comprehensive regulations, low awareness among market participants, and insufficient transparency in ESG disclosures. Moreover, issues like corruption and environmental degradation remain prevalent, indicating that ESG practices are not yet fully integrated into corporate governance in Indonesia.

A high ESG score reflects a company's commitment to environmental, social, and governance principles, and is positively associated with firm value, reputation, and investor confidence. From an Islamic perspective, ESG aligns with Sharia principles, which prohibit environmental harm and corruption, as emphasized in Surah Al-Baqarah verses 205 and 188. Therefore, it is crucial to further examine the impact of ESG on firm value within the context of the Islamic capital market, especially among companies listed in the ISSI index, to support broader and more sustainable ESG integration.

ESG practices among Indonesian companies, particularly in the non-financial and non-banking sectors, began gaining momentum around 2019. This period was selected due to the more stable availability of ESG data on the Bloomberg platform starting in 2018, allowing for more reliable and consistent analysis of ESG implementation in Indonesia. In the same year, Indonesia became the first country to issue a Green Sukuk worth USD 1.25 billion, demonstrating its commitment to green investment and sustainable development. With increasingly strict regulations and growing investor demands for sustainable business practices, the 2018–2023 period is ideal for analyzing the impact of ESG on firm value in Indonesia.

II. LITERATURE REVIEW

Islamic capital market

The Islamic capital market, often referred to as the stock exchange, functions similarly to conventional markets by facilitating transactions between buyers and sellers—except the traded instruments include equity ownership, corporate debt securities, commercial papers, stocks, bonds, and various derivatives. What differentiates the Islamic capital market is its adherence to Islamic principles, ensuring that all instruments and issuers comply with Shariah rules—prohibiting *riba* (interest), *gharar* (uncertainty), *maysir* (speculation), and investments in haram sectors like alcohol, gambling, and non-halal products. Its main objective is to establish a fair, transparent, and ethical financial system aligned with Islamic values, offering instruments such as Islamic stocks, sukuk (Islamic bonds), and Shariah-compliant mutual funds. In Indonesia, this market has grown significantly since the launch of Danareksa Syariah mutual fund in 1997 and the Indonesian Sharia Stock Index (ISSI), supported by OJK regulations and fatwas from DSN-MUI. As investor interest in ethical finance rises, ESG practices have become increasingly relevant in the Islamic capital market, as they align with Islamic ethics emphasizing sustainability, social responsibility, and good governance—making ESG a key consideration for Shariah-compliant investors.

Stakeholder Theory

Stakeholder Theory, pioneered by Edward Freeman and John McVea in their 1984 book *Strategic Management: A Stakeholder Approach*, builds upon earlier research from the Stanford Research Institute (SRI) in the 1960s. This theory posits that for long-term success, managers must consider the interests of all stakeholders—including shareholders, employees, customers, suppliers, lenders, and the broader community. Influenced by earlier works of Mitroff & Mason (1982) and Emshoff (1978), stakeholders are defined as any group or individual that affects or is affected by the organization's objectives. Freeman & McVea (2001) later emphasized that corporate management should integrate ethics and values into strategic decisions. Drawing from corporate planning, systems theory, CSR, and organizational theory, the stakeholder approach sees organizations as interconnected within a broader system, where collaboration among stakeholders leads to optimal solutions. In contrast to traditional corporate planning that treats stakeholders as constraints, the SRI approach integrates their interests as key to sustainable success. CSR further enriches this theory by highlighting the risks of ignoring marginalized groups like communities or environmental advocates. In this context, ESG aligns closely

with Stakeholder Theory as it combines economic, social, and environmental concerns, enabling firms to manage stakeholder relationships strategically and create long-term value through enhanced reputation, risk management, and legitimacy.

Shareholder Theory

Shareholder Theory was first introduced by Milton Friedman (1970), who argued that a company's primary responsibility is to maximize profits for its shareholders. According to this view, social or environmental responsibilities are not mandatory unless they directly contribute to profitability. This theory emphasizes that business decisions should prioritize shareholder interests rather than those of other stakeholders such as employees, society, or the environment. As a result, practices like ESG are considered inefficient under Shareholder Theory if they do not clearly enhance financial returns and may even reduce firm value. This explains why some studies find a negative relationship between ESG and firm value, as investors may perceive ESG as a financial burden that decreases profitability, particularly when sustainability investments do not yield immediate and tangible benefits. This aligns with Agency Theory, which suggests that managers may invest in ESG to boost their own reputation, conflicting with shareholder interests. Overinvestment Hypothesis and Trade-Off Theory also support this idea, arguing that excessive ESG investment may lead to suboptimal capital allocation and reduced short-term competitiveness. In contrast, Stakeholder Theory aligns more closely with Islamic economic principles, as it asserts that companies are responsible not only to shareholders but also to society, the environment, and other stakeholders. In Islamic Corporate Governance, this perspective reflects the concept of *maqashid syariah*, emphasizing that businesses should seek not only financial gain but also deliver social benefit and sustainability.

Agency Theory

Agency Theory, first introduced by Jensen et al. (1976) in their article *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, highlights the contractual relationship between shareholders (principals) and managers (agents) in a company. Conflicts of interest arise when managers prioritize their personal goals over those of shareholders. This theory is relevant in the context of sustainability, as managers may focus on stakeholders' interests, such as society or the environment, which may not align with shareholders' profit-driven goals, potentially negatively affecting financial performance. Agency Theory also addresses information asymmetry, where managers possess more knowledge about the company's operations than shareholders. In the case of ESG (Environmental, Social, Governance) disclosures, this imbalance can lead to shareholders misunderstanding the implications of managerial decisions. Lack of transparency in ESG reporting may result in managers concealing unfavorable decisions or exaggerating positive ones to improve their reputation. Clear and accurate ESG disclosures can reduce information asymmetry, build trust, and align the interests of managers and shareholders, thereby enhancing company value.

Overinvestment Theory

Overinvestment Theory explains that companies tend to overinvest when they have abundant resources, such as large cash flows, but without considering efficiency or shareholder value. Developed by Jensen et al. (1976) in the Agency Theory of Free Cash Flow, it suggests that when management has excess free cash flow, they often use it for projects that do not enhance company value but instead expand business scale or serve personal interests and reputations. This theory is relevant when companies adopt excessive ESG policies without careful consideration. While ESG can improve reputation and reduce risk, inefficient investment in ESG, done solely for image enhancement without tangible benefits, can diminish company value. For instance, spending large amounts on environmental programs without clear strategies or long-term financial benefits can reduce profitability, negatively affecting value as measured by Tobin's Q. Jensen notes that managers are more likely to reinvest funds back into the company rather than return them to shareholders, even if the investment is unprofitable. This can occur in ESG implementation if companies focus more on image than operational efficiency. Therefore, balancing ESG investments with their financial impact is crucial to avoid overinvestment that harms shareholders.

Tobin's Q

Firm value is a critical indicator used to reflect the overall market perception of a company's performance, stability, and growth potential. A high firm value indicates strong investor confidence and

suggests that the company is well-managed, financially healthy, and capable of generating future returns. This is essential not only for attracting new investors but also for maintaining long-term relationships with existing stakeholders (Adiputra & Hermawan, 2020). For instance, a company listed on the Indonesia Sharia Stock Index (ISSI) with consistently high firm value may signal to the market that it upholds both financial performance and ethical standards aligned with Islamic economic principles.

One widely recognized measure of firm value is Tobin's Q, introduced by Brainard and Tobin (1968). This ratio compares the market value of a company—including both equity and debt—to the replacement cost of its assets. A Tobin's Q greater than 1 implies that the market values the firm's assets more than their replacement cost, indicating efficient asset use and strong growth expectations. On the other hand, a Tobin's Q below 1 suggests underperformance or low investor confidence. For example, if a company like Astra International shows a Tobin's Q of 1.3, it reflects high investor trust in the company's ability to generate future value, whereas a value of 0.8 might raise concerns about its operational efficiency or market competitiveness.

Mathematically, the TobinsQ score can be calculated using the following equation:

$$TQ : \frac{(\text{Market Capitalisation} + \text{Total Liabilities} + \text{Preferred Equity} + \text{Minority Interest})}{\text{Total Assets}}$$

ESG

The rising global awareness among investors regarding environmental and non-financial factors—such as social responsibility and good governance—has created new challenges for companies to enhance their non-financial performance (Aydognmus et al., 2022). According to Freeman's stakeholder theory (1978), these efforts reflect the company's response to stakeholder expectations, including investors, employees, suppliers, customers, and regulators, who increasingly demand attention to environmental, social, and governance aspects. To address these expectations, companies now disclose their performance in these areas through ESG (Environmental, Social, and Governance) reporting.

Although the ESG concept gained prominence in the early 2000s, its elements were previously part of Corporate Social Responsibility (CSR), focusing on ethical and responsible business practices. ESG serves as a non-financial framework to evaluate a company's societal and environmental impact (Leong et al., 2023). According to the IDX, ESG is also a key tool for investment decisions and assessing business impact. The three ESG pillars—environment (carbon footprint, waste management), social (employee and community relations), and governance (leadership, audit, shareholder rights)—offer a comprehensive metric for corporate sustainability. Proper ESG implementation can enhance long-term value, reduce risk, and improve stakeholder trust, aligning with global calls for sustainability and the Islamic principle of stewardship, as echoed in Surah Al-Baqarah verse 30.

The ESG (Environmental, Social, and Governance) variable serves as a comprehensive framework for evaluating and managing a company's performance across environmental, social, and governance dimensions. In this study, ESG data is derived from ESG scores obtained via the Bloomberg Terminal, consistent with methodologies employed by Cantero-Saiz et al. (2024) and Azmi et al. (2021). Bloomberg ESG indicators are categorized into three primary pillars: Environmental (E), Social (S), and Governance (G), each reflecting specific non-financial risks and opportunities relevant to corporate sustainability.

Bloomberg analysts classify companies into peer groups based on similarities in business models, revenue sources, and ESG-related risks and opportunities. These groups are organized under the Bloomberg Environmental, Social, and Governance Industry Classification System (BECS), built upon the Bloomberg Industry Classification System (BICS). ESG scores are calculated at the BECS Level 3, emphasizing peer group comparability. Within each group, Bloomberg Intelligence assigns weightings to the ESG pillars based on financial materiality, rated on a scale of 1 (most material) to 5 (least material). Governance consistently receives a rating of 3 across peer groups, given its greater dependence on firm-specific and regional factors. These ratings are converted into percentage weights, and the final ESG score is derived using a generalized mean (power/p-mean) approach to reflect the relative contribution of each pillar. This methodology results in a composite ESG score, capturing the company's overall performance in environmental stewardship, social responsibility, and corporate governance.

Mathematically, the ESG score can be calculated using the following equation:

$$ESG\ Performance\ Score = \frac{\omega E \times E\ score + \omega S \times S\ score + \omega G \times G\ score}{\omega E + \omega S + \omega G}$$

$\omega E, \omega S, \omega G$ = Weight for each pillar Environmental, Social, and Governance

E score, S score, G score = Normalized scores for each pillar

Environmental Score

The environmental aspect of ESG involves efforts to minimize negative impacts on the environment through a company's operational activities and investment policies. In the context of banking and corporate finance, firms are expected to reduce harmful environmental effects not only from their internal processes but also by promoting environmentally friendly financing. This includes actions such as reducing energy consumption, limiting the use of natural resources, and minimizing externalities like pollution or ecological degradation. Companies, especially those listed in the Indonesian Sharia Stock Index (ISSI), are encouraged to integrate environmental responsibility into their corporate strategies. From a Sharia perspective, environmental stewardship aligns closely with Islamic ethical principles. Companies are expected to uphold the responsibility of preserving environmental balance as a form of worship and accountability to God. This is supported by the Qur'an in Surah Al-Baqarah verse 60.

The Environmental (E) score is used to evaluate a company's performance on environmental aspects, with data sourced from Bloomberg ESG scores, as in the studies by Aydogmus et al. (2022) and Azmi et al. (2021). Bloomberg Intelligence determines material risks and opportunities related to Environmental and Social (ES) factors for peer groups by analyzing global standards like SASB/ISSB and industry guidelines. The study also examines ESG disclosures from companies to assess their relevance and accuracy in addressing sustainability issues. Analysts then prioritize and rank key sustainability risks and opportunities, reflecting these in the ESG score, with justifications for each issue's importance.

Social Score

The Social (S) aspect of ESG includes human rights, employee welfare, corporate social responsibility, and the social impact of services offered. For companies listed in the ISSI, the implementation of social aspects aligns with the principles of justice as reflected in QS An-Nahl 90. The Social score (S) is a framework used to evaluate and manage a company's performance related to social aspects. The data used in this research is derived from ESG scores obtained from the Bloomberg terminal, as done in studies by Aydogmus et al. (2022) and Azmi et al. (2021). Bloomberg Intelligence determines material risks and opportunities related to Environmental and Social (ES) factors for each peer group, based on top-down analysis of global standards like SASB/ISSB and other industry-specific guidelines. The study also conducts a bottom-up analysis of ESG disclosures by companies, assessing the relevance and accuracy of the data used to address and measure sustainability issues. Subsequently, Bloomberg Intelligence analysts identify, prioritize, and rank key sustainability risks and opportunities, reflecting these in the ESG score, with justifications explaining the priority level of each issue.

Governance Score

The Governance (G) aspect of ESG emphasizes the importance of transparency, accountability, integrity in business practices, and the structure and diversity of independent directors. For companies listed in the ISSI, which follow Islamic principles, governance practices align with the Quranic verse about responsibility, specifically An-Nisa 58. The Governance score (G) serves as a framework to evaluate and manage company performance related to governance aspects. The data used in this research is derived from ESG scores obtained from the Bloomberg terminal, as seen in studies by Aydogmus et al. (2022) and Azmi et al. (2021).

Bloomberg calculates material issues in Governance (G) through both top-down and bottom-up approaches, which include analyzing global frameworks, corporate governance codes, and market-specific listing regulations. Company disclosures are also evaluated to identify relevant governance issues, considering factors such as company age and local market regulations. The issues in the G score are grouped into four main themes: Board Composition, Executive Compensation, Shareholder Rights, and Auditing. The weight of each issue is determined through fundamental research and can be adjusted, especially when dealing with binary variables or policies. The weight determination in the Governance

pillar score also considers the differences in ownership structures to provide a more accurate assessment.

III. RESEARCH METHODS

This research adopts a quantitative approach with the aim of testing hypotheses using measurable data, which can lead to conclusions that are generalizable. According to Sugiyono (2009), the quantitative approach is based on the philosophy of positivism and is used to study populations and random samples. The quantitative approach aims to test theories and build facts, show relationships between variables, present statistical descriptions, estimate, and predict outcomes (Uma Sekaran, 1992).

The research uses descriptive statistical analysis with a quantitative approach to examine the cause-and-effect relationships between independent variables (ESG Performance, Environmental Score, Social Score, and Governance Score) and the dependent variable, which is the company value as measured by Tobin's Q. This study investigates whether there is a relationship between ESG Performance, Environmental Score, Social Score, Governance Score, and their individual components with company value, as measured by Tobin's Q for companies listed on the ISSI. Control variables used in this research include company size and leverage, which aligns with the appropriate quantitative approach. The method employed is a causal quantitative method using the statistical software EVIEWS 12. Quantitative research is defined as a research method used to study specific populations or samples, where data is collected using research instruments, and data analysis is statistical, aimed at testing the established hypotheses (Basuki & Prawoto, 2017:253).

Empirical Model

The empirical model serves to explain the relationships between the variables being studied. From the results, the hypotheses formulated earlier can be interpreted. In this study, panel regression is used, with the empirical model adopted from the research by Aydogmus et al. (2022), which separates the combined ESG score and each component—Environmental (E), Social (S), and Governance (G)—to avoid multicollinearity. The dependent variable used is the company value, proxied by Tobin's Q, while the study examines four independent variables: ESG Performance Score (ESG) and the individual components of ESG, namely Environmental (E), Social (S), and Governance (G). The study also incorporates control variables for company size and leverage.

This study uses size and leverage control variables. The model equation in the panel regression analysis is as follows:

$$\text{Tobin's } Q_{it} = \alpha + \beta_1 \text{ESG}_{it} + \beta_2 \text{Size}_{it} + \beta_3 \text{Leverage}_{it} + \epsilon_{it} \dots (1)$$

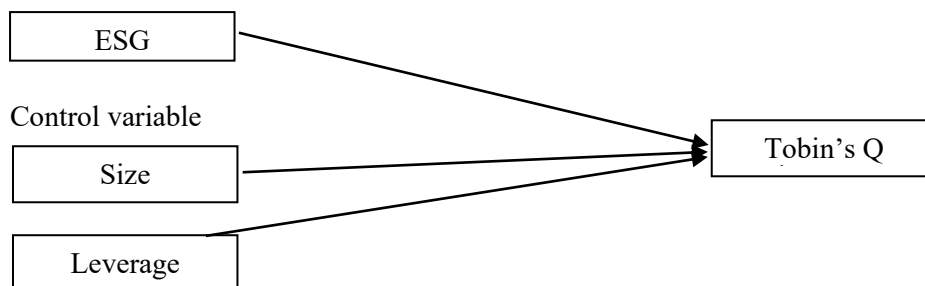
$$\text{Tobin's } Q_{it} = \alpha + \beta_1 E_{it} + \beta_2 S_{it} + \beta_3 G_{it} + \beta_4 \text{Size}_{it} + \beta_5 \text{Leverage}_{it} + \epsilon_{it} \dots (2)$$

This study uses secondary data. According to Sugiyono (2019), secondary data refers to data that is indirectly collected through a media intermediary. It refers to information obtained from existing sources. The analysis of secondary data involves re-analyzing data that has already been collected and processed. The secondary data in this study includes ESG performance variables, E score, S score, G score, company size, and leverage, sourced from the Bloomberg Database. This study utilizes data from the IDX database regarding companies listed on the ISSI each year. Data collection is done using panel data methodology, as it involves more than two samples per period and spans a specific time range. The following figure 1 and 2 are the research models used:

Population and Sample

According to Sekaran and Bougie (2017), a population refers to the entire group of people, events, or interests that a researcher wishes to investigate. The population in this study consists of companies listed in the Indonesian Sharia Stock Index (ISSI) during the period 2018–2023, totaling 262 companies, as obtained from the IDX Database. The sampling technique employed in this study is purposive sampling. According to Sugiyono (2018), purposive sampling is a technique of selecting samples based on specific criteria aligned with the objectives of the research, enabling the determination of an appropriate sample size. Through the purposive sampling method, a total of 30 companies listed in the ISSI for the period 2018–2023 that disclosed their ESG performance reports were selected as the sample for this study.

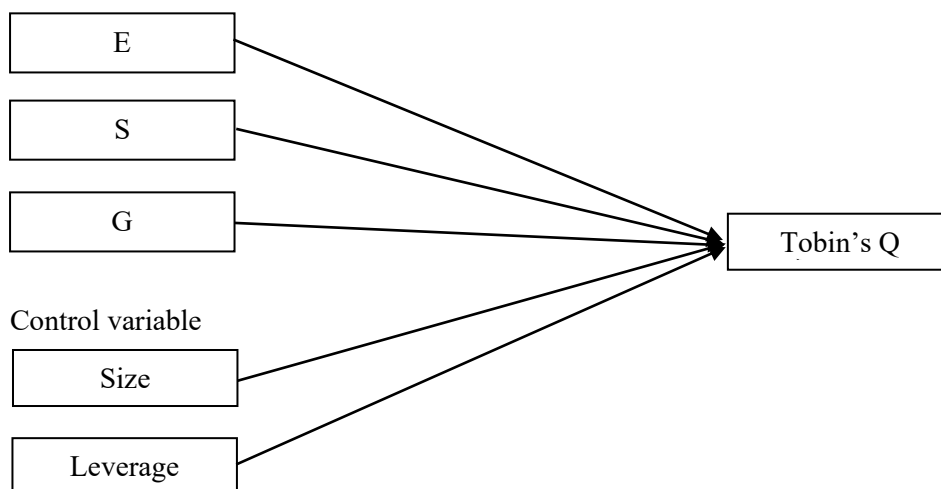
Model 1



Sumber: Author's own work (2025)

Figure 1. Research Model

Model 2



Sumber: Author's own work (2025)

Figure 2. Expanded Research Model

Analytical Method

This study employs panel data regression as the analytical framework to examine the relationship between the independent variables—ESG Performance, Environmental Score, Social Score, and Governance Score—and firm value, proxied by Tobin's Q, for companies listed in the Indonesian Sharia Stock Index (ISSI). Panel data is a combination of time-series and cross-sectional data (Basuki & Prawoto, 2017). The cross-sectional data in this study comprises 30 companies selected through purposive sampling, while the time-series dimension covers a five-year period from 2018 to 2023.

The data analysis techniques include descriptive statistical analysis, classical assumption testing, and panel regression analysis. These techniques are applied to evaluate the relationship between the independent variables—ESG Performance Score (ESG), Environmental Score (E), Social Score (S), and Governance Score (G)—and the dependent variable Tobin's Q, with firm size and leverage as control variables. The data were processed using EViews 12 Student Version and Microsoft Excel.

In panel data analysis, there are three main models used for testing model parameters: the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM) (Gujarati & Porter, 2009). The Common Effect Model (CEM) is the simplest estimation approach for panel regression. In this model, cross-sectional data—represented in this study by 30 companies listed in the Indonesian Sharia Stock Index (ISSI)—and time-series data covering the period from 2018 to 2023 are pooled together without considering temporal variations or differences between entities. CEM applies Ordinary Least Squares (OLS) regression, assuming that the effect of independent variables on the dependent variable is the same across individuals and over time. All observations are treated uniformly, disregarding any entity-specific or time-specific effects.

The Fixed Effect Model (FEM), on the other hand, is used when there is a need to control for unobserved variables that are constant over time but vary across entities. This model allows the researcher to isolate the effect of the independent variables by accounting for individual heterogeneity that cannot be observed. FEM identifies variation in intercepts across cross-sectional units—30 ISSI companies in this case—but assumes no variation over time (2018–2023). The error term in FEM is separated into an individual-specific effect (μ_{it}), which varies across entities but remains constant over time, and a residual error term (v_{it}) that varies both across entities and over time. The Random Effect Model (REM), as explained by Gujarati and Porter (2009), addresses limitations in FEM by accounting for individual heterogeneity without sacrificing degrees of freedom. Developed by Breusch and Pagan, REM uses Generalized Least Squares (GLS) for more efficient estimation compared to OLS. It incorporates individual-specific error terms and handles correlation in error components across both time-series and cross-sectional dimensions, making it suitable for large panel datasets with significant unobserved variability between individuals.

The selection of the appropriate panel data regression model is essential to ensure the validity and reliability of the research findings. To determine the most suitable model among the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM), several statistical tests are conducted, including the Chow Test, Hausman Test, and Lagrange Multiplier (LM) Test. The Chow Test is used to compare CEM and FEM, the Hausman Test to choose between FEM and REM, and the LM Test to compare REM and CEM. These tests help identify the model that best captures the individual and time-specific effects in panel data, particularly when analyzing ESG data from 30 companies listed in the ISSI over the 2018–2023 period.

Hypothesis Testing

According to Sugiyono (2017), hypothesis testing is a procedure used to determine whether to accept or reject the null hypothesis (H_0) based on sample data drawn from a population. The null hypothesis typically states that there is no difference or no relationship between the variables being studied. In this research, the null hypothesis indicates that there is no significant relationship between ESG variables and firm value. Three types of evaluation are used to analyze the regression model estimation results: partial significance testing (such as t-test and z-test), simultaneous significance testing (F-test), and the goodness of fit test (e.g., R-squared, adjusted R-squared, and pseudo R-squared).

Partial, Simultaneous, and Goodness of Fit Tests

The t-test is used to evaluate the individual significance of independent variables—namely ESG performance, Environmental Score, Social Score, and Governance Score—in explaining variations in the dependent variable, which in this case is firm value measured using Tobin's Q. If the significance value is greater than 0.05, H_0 is accepted, meaning the variable has no significant partial effect. The F-test, on the other hand, assesses whether all independent variables simultaneously influence the dependent variable. If the F-statistic is greater than the F-table or the significance value is less than 0.05, H_0 is rejected, indicating a significant collective influence. Lastly, the goodness of fit test evaluates how well the regression model fits the sample data using the R-squared value, which measures the proportion of the variance in firm value explained by the ESG variables. An R-squared closer to 1 indicates a better model fit.

IV. RESULTS AND DISCUSSION

Results

The Indonesia Sharia Stock Index (ISSI) serves as a benchmark for the performance of sharia-compliant stocks listed on the Indonesia Stock Exchange (IDX). It comprises all sharia stocks listed in the Sharia Securities List (DES) issued by the Financial Services Authority (OJK). Launched in 2011, ISSI was introduced alongside the issuance of DSN-MUI fatwa No. 80, which governs sharia principles in equity securities and regular stock market transactions. ISSI constituents are reviewed annually, leading to potential changes in the index's composition, unlike JII and JII70 which include fewer selected companies.

ISSI is calculated using a weighted average of market capitalization, similar to other IDX indices,

with December 2007 as the base year. As one of five sharia indices on the IDX, ISSI has experienced consistent growth in market capitalization since its inception—rising from IDR 1,968 trillion in 2011 to IDR 6,145 trillion in 2023. Significant dips only occurred in 2015, 2018, and during the COVID-19 crisis in 2020. Despite fluctuations, ISSI’s overall trajectory indicates growing interest and investment in sharia-compliant companies.

This steady growth in market capitalization is expected to align with greater adoption of ESG practices by companies listed under ISSI. ESG—covering environmental, social, and governance dimensions—is increasingly regarded as a critical measure of corporate sustainability. For sharia-compliant firms, ESG aligns closely with Islamic principles, which emphasize justice, environmental stewardship, and ethical governance. Thus, ESG adoption is not only a response to global sustainability trends but also a reinforcement of Islamic values in corporate operations.

Research by Gati et al. (2024) finds that ISSI-listed firms disclose ESG information more frequently than their non-ISSI counterparts, especially during and after the pandemic. However, disclosure levels vary due to firm-specific factors like size, leverage, and profitability. Regulatory pressures—such as POJK No. 51 of 2017, which mandates sustainable finance and reporting—also play a key role in driving ESG adoption across Islamic companies.

Despite growing awareness, ESG implementation among ISSI firms remains inconsistent. Bloomberg data from 2018 to 2023 shows that only 30 out of 629 DES-listed stocks consistently reported ESG. This reveals a gap between regulatory expectations and actual compliance, indicating that many sharia-based firms have yet to integrate ESG into their long-term business strategies. Continued policy support and market incentives are necessary to encourage more consistent and comprehensive ESG practices across the ISSI landscape.

Table 1. List of ISSI Companies Consistently Reporting ESG

No	Ticker Code	Company Name
1	AALI	PT Astra Agro Lestari Tbk
2	ACES	PT Aspirasi Hidup Indonesia Tbk
3	ADRO	PT Adaro Energy Indonesia Tbk
4	ANTM	PT Aneka Tambang Tbk
5	ASRI	PT Alam Sutera Realty Tbk
6	BRIS	PT. Bank Syariah Indonesia Tbk
7	CTRA	PT Ciputra Development Tbk
8	EXCL	PT XL Axiata Tbk
9	ICBP	PT Indofood CBP Sukses Makmur Tbk
10	INCO	PT. Vale Indonesia Tbk
11	INDF	PT. Indofood Sukses Makmur Tbk
12	ISAT	PT Indosat Ooredoo Hutchison Tbk
13	ITMG	PT. Indo Tambangraya Megah Tbk
14	JPFA	PT Japfa Comfeed Indonesia Tbk
15	KLBF	PT Kalbe Farma Tbk
16	LPPF	PT Matahari Departement Store Tbk
17	LSIP	PT Perusahaan Perkebunan London Sumatra Indonesia Tbk
18	MAPI	PT Mitra Adiperkasa Tbk
19	MNCN	PT. Media Nusantara Citra Tbk
20	PGAS	PT. Perusahaan Gas Negara Tbk
21	PTBA	PT Bukit Asam Tbk
22	PTPP	PT Pembangunan Perumahan (Persero) Tbk
23	PWON	PT. Pakuwon Jati Tbk
24	RALS	PT Ramayana Lestari Sentosa Tbk
25	SCMA	PT Surya Citra Media Tbk
26	SILO	PT Siloam International Hospitals Tbk
27	SMRA	PT Summarecon Agung Tbk
28	TLKM	PT Telkom Indonesia Tbk
29	UNTR	PT United Tractors Tbk
30	WTON	PT Wijaya Karya Beton Tbk

Source: Data processed by the researcher from IDX. 2025.

This reflects that while ESG has become an important factor in Sharia-based investment, its

implementation still faces challenges such as weak regulatory enforcement, limited managerial awareness, and resource constraints in sustainability reporting. A more systematic approach is needed to promote consistent ESG practices in ISSI-listed companies for a more competitive and sustainable Islamic capital market.

Table 2. Descriptive Statistics

Variable	Obs.	Mean	Median	Min.	Max	Std. Dev.
ESG	180	2,991778	2,870000	0,820000	5,590000	1,198726
E	180	2,312722	1,690000	0,000000	6,340000	1,876605
S	180	3,000000	3,040000	0,000000	6,800000	1,761795
G	180	4,392222	4,300000	2,520000	5,960000	0,759305
Size	180	4,345722	4,385000	3,060000	5,550000	0,541732
Leverage	180	59,48522	30,13000	0.000000	1171,352	114,8095
TobinsQ	180	1,496833	1,190000	0,340000	4,800000	0,867504

Source: Data processed by the researcher using Eviews12. 2025.

This study employs six variables: Tobin's Q as the dependent variable to proxy firm value, and ESG Performance Score, Environmental Score, Social Score, Governance Score, firm size, and leverage as independent and control variables. The panel data consists of 30 companies consistently listed in the ISSI and reporting ESG performance over six years (2018–2023). Using the Random Effect Method, descriptive statistics show that ESG Score averages 2.99, while Environmental, Social, and Governance Scores average 2.31, 3.00, and 4.39, respectively. Firm size averages 4.30, leverage 59.49, and Tobin's Q 2.31, each with varying standard deviations, minimums, and maximums across the sample.

The model estimation in this study was determined through several testing stages. First, the Chow Test was conducted to choose between the Common Effect Model (CEM) and the Fixed Effect Model (FEM). Then, the Hausman Test was used to select between FEM and the Random Effect Model (REM). If the Chow Test indicates a probability < 0.05 and the Hausman Test shows a probability > 0.05 , the REM is selected, and the Lagrange Multiplier Test is then applied to decide between CEM and REM. This study uses two models: Model 1 examines the aggregated effect of ESG on firm value (proxied by Tobin's Q) with firm size and leverage as control variables, while Model 2 tests the individual influence of Environmental, Social, and Governance scores on firm value with the same controls. Each model undergoes the three tests—Chow, Hausman, and Lagrange Multiplier—to determine the most appropriate estimation approach for analyzing the impact of ESG on firms listed in ISSI during 2018–2023.

Table 3. Result of Model Selection Test 1

Test	P-value	Result
Chow	<i>Prob</i> 0,0000 $< 0,05$	FEM
Hausman	<i>Prob</i> 0,2144 $> 0,05$	REM
Lagrange Multiplier	<i>Prob</i> 0,0000 $< 0,05$	REM

Source: Data processed by the researcher using Eviews12. 2025.

Based on Table 3, the Random Effect Model (REM) is the most appropriate model for this study. The Chow test showed a probability value of 0.0000 (< 0.05), selecting the Fixed Effect Model (FEM). However, the Hausman test result was 0.2144 (> 0.05), indicating REM as the preferred model. As REM was chosen in the Hausman test, the Lagrange Multiplier test was conducted, and with a Breusch-Pagan probability of 0.0000 (< 0.05), REM was confirmed as the best model for estimating the effect of ESG on firm value (Tobin's Q).

Table 4. Result of Model Selection Test 2

Test	P-value	Result
Chow	<i>Prob</i> 0,0000 $< 0,05$	FEM
Hausman	<i>Prob</i> 0,0930 $> 0,05$	REM
Lagrange Multiplier	<i>Prob</i> 0,0000 $< 0,05$	REM

Source: Data processed by the researcher using Eviews12. 2025.

Based on Table 4, the Random Effect Model (REM) is the most suitable model for this study. REM is used to examine the influence of Environmental, Social, and Governance variables on firm value (Tobin's Q), with firm size and leverage as control variables. In the model selection process, the Chow test (Step 1) shows a probability of 0.0000 (< 0.05), selecting the Fixed Effect Model (FEM). The Hausman test (Step 2) yields a probability of 0.0930 (> 0.05), indicating REM as the preferred model.

Since REM was selected in the Hausman test, the Lagrange Multiplier test (Step 3) was conducted, and with a Breusch-Pagan probability of 0.0000 (< 0.05), REM is confirmed as the final model.

Table 5. Result Model 1

Independent Variable	Coefficient	Dependent Variable: TobinsQ Std. Error	T Statistic	Prob.
C	4,172187	0,814187	5,124360	0,0000
ESG	-0,142436	0,063927	-2,228101	0,0271
SIZE	-0,506280	0,178313	-2,839275	0,0051
LEV	-0,001249	0,000506	-2,470542	0,0144
R-Squared	0,119446		F-statistic	7,958089
Adj. R-Squared	0,104437		Prob(F-statistic)	0,000053
Obs.	180			

Source: Data processed by the researcher using Eviews12. 2025.

Based on the regression estimation results in Table 5, the coefficients can be interpreted as follows: the constant (C) indicates that when all independent variables are zero, Tobin's Q, as the dependent variable, is valued at 4.172 with a probability of 0.0000 (< 0.05). ESG, as the aggregated independent variable, has a coefficient of -0.142, indicating a negative and significant relationship with Tobin's Q; a one-unit increase in ESG leads to a 0.142 decrease in Tobin's Q, assuming other variables remain constant ($p = 0.0271 < 0.05$). Firm size (SIZE) has a coefficient of -0.506, also showing a significant negative effect on Tobin's Q ($p = 0.0051 < 0.05$), meaning a one-unit increase in SIZE reduces Tobin's Q by 0.506. Leverage (LEV), proxied by the debt-to-equity ratio, has a coefficient of -0.001, indicating a significant negative effect on Tobin's Q ($p = 0.0144 < 0.05$), where a one-unit increase in LEV reduces Tobin's Q by 0.001, holding other variables constant.

Table 6. Result Model 2

Independent Variable	Coefficient	Dependent Variable: TobinsQ Std. Error	T Statistic	Prob.
C	3,705052	0,866546	3,841933	0,0002
E	-0,133245	0,048247	-2,992116	0,0032
S	-0,039014	0,038528	-1,016644	0,3107
G	0,095125	0,084442	1,110305	0,3684
SIZE	-0,492270	0,176351	-2,392200	0,0178
LEV	-0,001414	0,000420	-3,134683	0,0020
R-Squared	0,149660		F-statistic	6,124825
Adj. R-Squared	0,125225		Prob(F-statistic)	0,000030
Obs.	180			

Source: Data processed by the researcher using Eviews12. 2025.

Based on the panel data regression results in Table 6, the coefficients can be interpreted as follows: the constant (C) indicates that when all independent variables are zero (E, S, G, SIZE, LEV), Tobin's Q is valued at 3.705 with a probability of 0.0002 (< 0.05). The Environmental (E) score has a coefficient of -0.133, showing a significant negative effect on Tobin's Q, where a one-unit increase in E lowers Tobin's Q by 0.133 ($p = 0.0032 < 0.05$). The Social (S) score has a coefficient of -0.039, indicating a negative but not significant relationship with Tobin's Q ($p = 0.3107 > 0.05$). The Governance (G) score has a positive coefficient of 0.0095, but its effect on Tobin's Q is also not statistically significant ($p = 0.3684 > 0.05$). Firm size (SIZE) has a coefficient of -0.492, suggesting a significant negative impact on Tobin's Q, with a one-unit increase in SIZE reducing Tobin's Q by 0.492 ($p = 0.0178 < 0.05$). Leverage (LEV), proxied by the debt-to-equity ratio, has a coefficient of -0.001, indicating a significant negative relationship with Tobin's Q, where a one-unit increase in LEV decreases Tobin's Q by 0.001 ($p = 0.0020 < 0.05$).

The results of the partial significance (t-statistic) test reveal that the ESG Score variable has a statistically significant and negative effect on firm value proxied by Tobin's Q, with a regression coefficient of -0.142 and a p-value of 0.0271 ($p < 0.05$), indicating that an increase in ESG performance is associated with a decrease in Tobin's Q, holding other variables constant. Further analysis using disaggregated ESG dimensions shows that the Environmental Score (E) also exerts a significant negative influence on firm value, with a coefficient of -0.133 and a p-value of 0.0032 ($p < 0.05$). In contrast, the Social Score (S) has a coefficient of -0.039 with a p-value of 0.3107 ($p > 0.05$), indicating

no statistically significant impact on Tobin's Q. Similarly, the Governance Score (G) yields a coefficient of 0.0095 and a p-value of 0.3684 ($p > 0.05$), suggesting a non-significant and slightly positive relationship with firm value. Regarding firm-specific control variables, firm size (SIZE) demonstrates a significant negative effect, with coefficients of -0.506 ($p = 0.0051$) in Model 1 and -0.492 ($p = 0.0178$) in Model 2, implying that larger firms tend to have lower market value relative to asset replacement costs. Leverage (LEV), proxied by the debt-to-equity ratio (DER), also shows a consistent significant negative effect across both models, with coefficients of -0.001 and p-values of 0.0144 (Model 1) and 0.0020 (Model 2). These findings suggest that while aggregate ESG performance and environmental concerns negatively influence firm value in this sample, social and governance dimensions are not statistically impactful, and internal firm characteristics such as size and leverage significantly contribute to the variation in Tobin's Q.

The F-statistic test was conducted to assess the joint significance of all independent variables on the dependent variable, Tobin's Q, as a proxy for firm value. Two regression models were tested. In Model 1, which included ESG Score, firm size (SIZE), and leverage (LEV) as explanatory variables, the F-statistic yielded a probability value of 0.000053 ($p < 0.05$). This result indicates that ESG, SIZE, and LEV collectively have a statistically significant influence on Tobin's Q at the 5% level, thereby rejecting the null hypothesis and confirming the simultaneous relevance of these variables in explaining variations in firm value among firms listed in the Indonesian Sharia Stock Index (ISSI) during the 2018–2023 period. In Model 2, the disaggregated ESG dimensions—Environmental (E), Social (S), and Governance (G) scores—alongside SIZE and LEV were analyzed. The F-statistic result showed a p-value of 0.000030 ($p < 0.05$), further confirming that E, S, G, SIZE, and LEV jointly exert a significant impact on Tobin's Q. Thus, both models consistently demonstrate that the set of independent variables exerts a significant collective influence on firm value in the context of ISSI-listed companies over the observed period.

The coefficient of determination (R-squared) is used to evaluate the explanatory power of the independent variables in a regression model on the dependent variable, ranging from 0 to 1, with values closer to 1 indicating stronger explanatory capability. In Model 1, the R-squared value reported in Table 5 is 0.11944, indicating that ESG (as an aggregate score), firm size (SIZE), and leverage (LEV) collectively explain approximately 12% of the variation in Tobin's Q, a proxy for firm value, among ISSI-listed companies during the 2018–2023 period. The remaining 88% is attributed to other factors not included in this study. In contrast, Model 2, as shown in Table 6, yields an R-squared value of 0.14966, suggesting that when ESG is disaggregated into its individual Environmental (E), Social (S), and Governance (G) components along with SIZE and LEV, the model explains around 15% of the variation in Tobin's Q. This improvement implies that separating ESG into its constituent dimensions enhances the model's explanatory power, enabling it to better capture the impact on firm value. According to Aydogmus et al. (2022), this occurs because the effects of E, S, and G can offset one another when combined into a single ESG score—where a positive influence from one component (e.g., S or G) might be neutralized by a negative effect from another (e.g., E), thereby obscuring the true relationship. Disaggregating ESG allows for clearer identification of which specific component contributes most significantly to firm value. Additionally, as noted by Atan et al. (2019), models with a greater number of independent variables tend to yield higher R-squared values, as they account for more variation in the dependent variable.

Discussion

The Impact of ESG on Firm Value

Based on the REM regression findings, this study provides empirical evidence that the ESG Score has a significant negative effect on firm value, as proxied by Tobin's Q, for companies listed in the Indonesian Sharia Stock Index (ISSI) during 2018–2023. The hypothesis is accepted since the probability value is below the 0.05 significance level, indicating that a one-unit increase in ESG Score is associated with a decrease in Tobin's Q. Conceptually, ESG Score reflects the implementation of environmental, social, and governance initiatives, yet studies in developing countries often reveal its negative or insignificant effect on firm value due to high implementation costs and lack of immediate profitability.

This result aligns with previous research suggesting that ESG policies often burden firms in

emerging markets due to inadequate regulatory frameworks and limited investor awareness (Kalia & Aggarwal, 2023). In Indonesia, ESG implementation still faces structural and regulatory challenges. Existing policies such as POJK No. 51/POJK.03/2017 mandate sustainability reporting but are not uniformly enforced across sectors. Moreover, laws like UU No. 32/2009 and UU No. 40/2007 only cover partial ESG aspects, contributing to low transparency and investor uncertainty regarding ESG commitments.

The high cost of ESG implementation, viewed as reducing short-term profitability, may also lead investors to perceive ESG initiatives as resource-draining and misaligned with core business focus (Al-Tarawneh et al., 2024; Di Tommaso & Thornton, 2020). This supports the overinvestment theory, where ESG engagement diverts limited resources from value-adding investments. From an agency theory perspective (Jensen & Meckling, 1976), ESG may reflect managerial pursuit of non-financial goals at the expense of shareholder interests, fueling investor skepticism. Trade-off theory further explains that investors may not fully appreciate long-term ESG benefits, viewing them instead as cost burdens.

From an Islamic economics perspective, business should aim not only for profit but also for societal, environmental, and governance benefits, aligning with stakeholder theory. However, this study reveals that shareholder interests still dominate, causing ESG to be perceived as a non-essential cost. Even though sharia principles promote environmental sustainability, social responsibility, and trustworthy governance, the reality shows that investors in ISSI tend to prioritize short-term profits. While studies like Khanifah et al. (2020) suggest ESG may enhance reputation in the long run, such benefits are often overlooked in immediate market evaluations. Consistent ESG adoption, in line with sharia values like *maslahah* (public interest) and accountability, can strengthen competitive advantage and firm value sustainably.

A further reason for the negative ESG–firm value link lies in the mismatch between ESG assessment by Bloomberg and the sharia screening criteria (DES–OJK), which are conducted biannually. DES criteria prioritize compliance with Islamic principles, such as the prohibition of *riba*, *gharar*, and unethical business activities. Financial thresholds like debt-to-assets and non-halal income ratios are used for classification. While these reflect good governance principles, environmental and social aspects are not comprehensively addressed. Islamic teachings, however, strongly emphasize sustainability and ethical responsibility. This is illustrated in QS Al-Ahqaf (46:13): *"Indeed, those who say 'Our Lord is Allah' and then remain steadfast – no fear will there be concerning them, nor will they grieve."* This verse reminds us of the long-term spiritual and societal value of consistently upholding righteousness, including in corporate behavior aligned with ESG principles.

According to the Wajiz interpretation, the verse explains that those who declare "Our Lord is Allah" and remain steadfast in their commitment to follow Allah's guidance will not fear or grieve, regardless of what happens. In the Hereafter, they will be the inhabitants of paradise, rewarded for their deeds. The Tahlili interpretation further explains that those who truly believe in Allah, maintaining their faith without any form of shirk, will be secure on the Day of Judgment. They will not regret anything they left behind in this world, as Allah guarantees their safety.

This verse aligns with the ESG principle in enhancing corporate value. Consistently demonstrating a commitment to sustainable business practices builds trust with stakeholders, leading to stability in facing market risks, regulations, and environmental crises, thus strengthening long-term corporate value. Sustainable ESG practices benefit society, the environment, and the economy, improving corporate performance, including metrics like Tobin's Q and business reputation. This verse emphasizes that steadfastness in good practices, including sustainable business, brings trust, stability, and welfare to both the company and its stakeholders.

The research aligns with Khanifah et al. (2020), which suggests that although sustainability performance may negatively impact a company's value, it positively influences reputation. A good reputation increases customer loyalty and attracts investors focused on sustainability, although these effects are more evident in the long term. By consistently implementing ESG, companies can build strong reputations, reduce business risks, and enhance investor trust. From an Islamic economic perspective, steadfast ESG implementation reflects adherence to values like social responsibility and contributes strategically to enhancing competitiveness and sustainable corporate value.

Considering issues in Indonesia, such as suboptimal ESG regulations and the lack of alignment

between Islamic stock selection methods and ESG sustainability principles, it's essential to look at best practices from other countries. Research by Chen & Zhang (2024) highlights how countries in the Asia Pacific, like Singapore and Japan, have integrated ESG practices and regulatory frameworks that boost corporate value. In these countries, ESG is seen as part of business strategy and risk management, with regulations that encourage disclosure. However, Indonesia still lacks a strong, standardized ESG disclosure framework.

A study by Nguyen et al. (2022) in the United States found that better ESG practices significantly improve company performance, particularly in market value as measured by Tobin's Q. The study emphasizes the role of standardized ESG ratings, investor support for sustainable investments, and government intervention. In contrast, Indonesia lacks a unified national ESG scoring standard, unlike international schemes like MSCI and Sustainalytics. The market's positive response to ESG information indicates its importance in evaluating a company's intrinsic value. Thus, the challenges facing ESG in Indonesia stem from weak regulations, short-term investor focus on profitability, and inconsistent ESG evaluation criteria.

The Impact of Environmental Factor on Firm Value

Based on the results from the regression analysis in Table 6, there is empirical evidence that the environmental score variable has a significant negative impact on company value, as proxied by Tobin's Q, for firms listed in the ISSI between 2018 and 2023. Therefore, the hypothesis of this research is accepted. The probability value of the environmental score (E) is below the 0.05 significance level, at 0.0032, with a coefficient of -0.133245, indicating that a one-unit increase in the environmental score will decrease Tobin's Q by 0.133245. Conceptually, environmental score contributes to the implementation of environmental policies and practices. The relationship between environmental score and company value varies in existing studies, with some indicating positive effects on risk reduction and reputation improvement, while others suggest no significant impact, particularly when environmental factors are not prioritized by investors.

In developing countries, the implementation of environmental policies still faces challenges. Atan et al. (2019) stated that in countries like Malaysia, ESG is often seen more as a regulatory compliance measure rather than a business strategy to enhance profitability. This finding is consistent with Khanifah et al. (2020), who noted that in Indonesia, investors prioritize profitability over environmental performance when making investment decisions. Thus, a high environmental score does not necessarily improve company value, as environmental expenditures may lead to increased operational costs that are not immediately correlated with market value. While environmental performance may positively affect a company's reputation, it often yields long-term benefits rather than immediate improvements in market value, aligning with findings by Gawęda (2025), who observed that high ESG scores, including environmental performance, can decrease company value globally.

These findings suggest a gap between Islamic principles, such as *hifzh al-bi'ah* (environmental protection), and the practices observed in Indonesia's Islamic capital market. While Islam emphasizes the responsibility to maintain environmental sustainability (*QS Al-Baqarah: 30*), Indonesian investors still focus primarily on short-term profitability. This is reflected in stakeholder theory and overinvestment theory, which suggest that the interests of shareholders dominate, leading to the perception that environmental investments are unnecessary costs rather than long-term strategic benefits. From an Islamic economic perspective, businesses should prioritize not only financial profits but also ensure their activities benefit society and the environment. However, this research indicates that in practice, investors in ISSI still prioritize financial performance over environmental concerns, highlighting the need for stronger regulation and incentives to integrate environmental sustainability into business strategies.

The Impact of Social Factor on Firm Value

The empirical results from the Random Effect Model (REM) regression analysis indicate that the social score variable does not have a significant effect on firm value, as proxied by Tobin's Q, for companies listed in the ISSI between 2018 and 2023. The probability value for the social score variable (S) is above the significance level of 0.05, at 0.3107, with a coefficient of -0.039014, meaning that a one-unit increase in the social score leads to a 0.039014 decrease in Tobin's Q. This suggests that, despite changes in the social score, there is no significant impact on the market value of the companies

in the ISSI.

Previous studies on the effect of social scores on firm value have produced mixed results. These variations are due to factors such as the country of the study, investor preferences in evaluating corporate social policies, the level of ESG regulation, and the economic conditions at the time of the research (Bai et al., 2024, Buallay et al., 2024, Nguyen et al., 2022, Atan et al., 2019). Some studies, such as those by Buallay et al., 2024, Inamdar, 2022, and Aydogmus et al., 2022, found that social scores positively impact firm value, suggesting that corporate social responsibility (CSR) can enhance a company's reputation and public trust, thus increasing its market value. However, this research aligns with the findings of Atan et al., 2019 and Shahrin et al., 2023, which show no significant effect of social scores on Tobin's Q, indicating that in some emerging markets, social aspects of a company's operations are not considered major factors in market valuation by investors.

In the context of Islamic economics, social aspects of ESG are expected to have a positive impact on firm value, as Islam emphasizes societal welfare (maslahah) and social justice in business practices. The principles of ta'awun (cooperation) and social justice are part of Islamic business ethics, where companies that are more socially responsible should be valued in the Islamic capital market. However, this study's findings indicate that the ideal of Islamic economics regarding social aspects has not fully translated into investment practices in the ISSI, as investors still prioritize short-term financial performance over long-term social benefits. This highlights the need for greater investor awareness and stronger regulations to ensure that the social aspect of ESG is not just a normative obligation but is seen as a part of a business strategy that can enhance long-term firm value.

The Impact of Governance Factor on Firm Value

The empirical results from the REM regression analysis in Table 4.12 provide evidence that the governance score does not have a significant effect on firm value, as proxied by Tobin's Q, for companies listed in the ISSI from 2018 to 2023. The probability value for the governance score (G) is above the significance level of 0.05, at 0.3684, with a coefficient of 0.095125, indicating that a one-unit increase in governance score would increase Tobin's Q by 0.095125. This suggests that despite an increase in governance score, there is no significant effect on the market value of companies in the ISSI.

Descriptive statistics in this study show that governance scores have the highest average among the ESG components, with a mean of 4.39, a minimum value of 2.52, and a maximum of 5.96. This indicates that many ISSI companies have relatively good governance practices, although there is considerable variation between companies with low and high scores. However, the regression results indicate that although better governance theoretically improves firm value, the effect is not strong enough in Indonesia's Islamic capital market to significantly impact Tobin's Q. This finding aligns with Shahrin et al. (2023), who also found that governance scores positively impact firm value in Malaysia, but the effect was not significant.

This study also supports Kartikasary et al. (2023), which suggests that governance scores are not significant in influencing firm value, as companies in Southeast Asia do not prioritize governance quality. Investors in emerging markets tend to focus more on short-term profitability rather than long-term governance benefits. The high governance score in the ISSI sample shows that most companies have good governance practices, but the differences between companies are not large enough to create a significant impact on firm value. This is consistent with Agency Theory (Jensen & Meckling, 1976) and Shareholder Theory (Friedman, 1970), which argue that good governance reduces conflicts of interest but is not enough on its own to significantly improve firm value in the short term.

V. CONCLUSION

This study examines the impact of Environmental, Social, and Governance (ESG) factors on firm value using a sample of companies listed on the Indonesian Sharia Stock Index (ISSI) from 2018 to 2023. The research analyzes both the composite ESG score and the individual scores for each pillar (E, S, and G) to address gaps in prior studies that lack consistent results on the effect of ESG on firm value. Two models are employed to explore these relationships, consistent with previous studies (Aydogmus et al., 2022; Atan et al., 2019; Inamdar et al., 2024).

The results indicate that both the composite ESG score and the environmental (E) aspect have a

significant negative effect on firm value. This suggests that ISSI investors are more focused on short-term profits, viewing ESG as an expense that does not support immediate profitability. The social (S) aspect shows a negative but insignificant effect, implying that while social factors are considered, their impact on firm value is not strong enough. The governance (G) aspect, although positive, does not significantly influence firm value, indicating that investors may not yet fully appreciate the benefits of good governance in investment decisions.

The study employs Shareholder, Trade-Off, Agency, and Overinvestment theories to explain the influence of ESG variables on firm value. Shareholder theory posits that the primary goal of a firm is to maximize shareholder wealth, explaining why investors may perceive ESG expenditures as financial burdens that reduce profitability. Agency theory (Jensen & Meckling, 1976) suggests that ESG investments may create conflicts between managers and shareholders if such investments do not yield financial returns. Furthermore, the Overinvestment Hypothesis (Jensen, 1986) and Trade-Off Theory (Kraus & Litzenberger, 1973) highlight that excessive ESG spending without adequate returns may undermine short-term profitability and reduce financial efficiency.

From an Islamic economics perspective, these findings align more with the Shareholder Theory, which emphasizes short-term profitability over long-term sustainability. However, in Islamic finance, firms should not solely focus on financial profits but also consider social welfare and environmental sustainability, as emphasized by Stakeholder Theory (Freeman, 1984). The study also identifies policy gaps that need to be addressed, such as the need for stronger ESG regulations and incentives for compliant companies. These findings offer insights into the factors determining firm value in Indonesia, where ESG is often seen as an overinvestment due to insufficient regulation and short-term investor priorities.

This research highlights the gap between Islamic economic theory, which emphasizes a balance between profit and social benefits, and the behavior of investors who still tend to focus on financial gains. Therefore, the results of this study can serve as a valuable reference with recommendations for various stakeholders. Firstly, the government needs to adopt stronger policy approaches to encourage companies to remain committed to ESG without compromising their economic value, aligning with Islamic principles that emphasize the balance between sustainable business practices and social benefits. The government should formulate regulations that promote the enhancement of ESG and implement long-term policies in line with ESG. Additionally, the government is advised to strengthen the role of the Financial Services Authority (OJK) in developing better and more comprehensive ESG rating systems and criteria, so it can provide clear guidance for companies and enhance the credibility of sustainability reports. This refers to best practices implemented in countries like Singapore and Japan, where the success of integrating ESG in increasing corporate value is supported by strict regulations and credible ESG rating systems. The government could offer incentives for compliant companies, such as tax reductions or access to sustainable financing. The findings of this study also provide insights for academics regarding the determinants of corporate value, which were previously rarely discussed, especially in the context of integrating ESG and Islamic economics in Indonesia's financial market.

Secondly, for future investors, this phenomenon indicates that when considering investments in companies implementing ESG practices, investors need to adopt a broader perspective regarding the relationship between shareholder expectations and managerial goals related to ESG. If ESG is not managed properly, its impact could lead to financial difficulties for the company. This can be avoided, one way being through adequate government regulations and policies. Therefore, there needs to be integration between investors, companies, and the government in the sustainable implementation of ESG practices. Thirdly, managers of companies aiming to maximize corporate value should continue and enhance their ESG performance while also considering the company's long-term strategy. Companies need to balance investments in ESG with profitability to avoid overinvestment that could reduce capital efficiency. Furthermore, companies should adopt long-term value-based ESG approaches, such as innovation in environmentally friendly technologies that can improve operational cost efficiency.

Last but not least, in the future, academics need to conduct more empirical studies to understand how each aspect of ESG affects corporate value under different industry and economic conditions. By comparing ESG as a single aggregate variable versus breaking it down into Environmental, Social, and

Governance factors, richer insights can be gained regarding the specific role of each factor. To address potential bias in ESG measurements, academics should expand their data scope by using ESG scores from various rating agencies such as Bloomberg, MSCI, Morningstar, and Refinitiv. Each agency has different data sources, assessment methodologies, and score weights, which may affect the research results. By comparing these different ESG methodologies, future research could identify systematic differences in ESG measurement and how these differences affect corporate value across various markets and industries. Future research is encouraged to compare corporate value between companies that implement ESG practices and those that do not, to provide a clearer picture of how much ESG contributes to corporate value. This comparison is especially important in developing countries like Indonesia, where not all companies consistently adopt ESG. Future studies could be expanded to compare the effectiveness of ESG across different industry sectors. For example, the mining sector, which is often considered to have a negative environmental impact within ESG, could be compared to more environmentally friendly sectors like technology or services. This segmentation can help identify which sectors are most impacted by the application of ESG to corporate value. Finally, it is suggested that future studies also examine the impact of ESG over different time horizons, both short-term and long-term. This aims to capture the time dynamics in market responses to corporate ESG commitments. While ESG may not show an immediate impact on corporate value in the short term, it may significantly contribute in the long term as investor awareness increases and companies adjust their business strategies.

AUTHOR CONTRIBUTIONS

Conceptualization, F.P.N.A. and S.F.; methodology, F.P.N.A. and S.F.; software, F.P.N.A.; validation, F.P.N.A.; formal analysis, F.P.N.A.; investigation, F.P.N.A.; resources, F.P.N.A.; data curation, F.P.N.A.; writing – original draft preparation, F.P.N.A.; writing – review and editing, F.P.N.A.; visualization, F.P.N.A.; supervision, S.F.

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Not applicable.

DATA AVAILABILITY STATEMENT

The data that support the findings of this study are available on request from the corresponding author, [F.P.N.A.].

CONFLICTS OF INTEREST

The authors declare no conflicts of interest.

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