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ANALYZING THE IMPACT OF ESG ON COMPANY VALUE THROUGH CAPITAL STRUCTURE

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Abstract

The application of Environmental, Social, and Governance (ESG) principles is increasingly important in the modern business world because it reflects a company's commitment to sustainability, social responsibility, and good governance. ESG is not just a moral obligation, but an important strategy in creating long-term value for the company and supporting economic sustainability in general. This study aims to analyze the effect of Environmental, Social, and Governance (ESG) disclosure on company value, with capital structure as a mediating variable. This study uses a quantitative approach with secondary data from companies listed on the Indonesia Stock Exchange (IDX) and have an IDXLeaders index during the period 2021 to 2024. The sampling technique in this study uses purposive sampling with the criteria for companies included in the IDXLEADERS category. The number of samples obtained was 14 companies. ESG measurement is carried out by looking at the IDXLeaders index on the IDX, capital structure is measured by Debt to Equity Ratio, and Company value is measured by Tobins Q. Data analysis was carried out using Smart PLS 4. The results of the study show that (1) ESG disclosure has no effect on company value. In emerging markets such as Indonesia, investors tend to focus more on short-term financial performance than ESG practices. As a result, even though companies have good ESG scores, this is not always reflected in increased company value. (2) ESG is proven to have a positive effect on capital structure. The positive effect of ESG on capital structure may reflect a company's strategy in utilizing their ESG reputation to access financing to support growth and sustainability initiatives. (3) capital structure has an effect on company value. This indicates that optimal use of capital can increase company value and reflect good financial policies. (4) capital structure is not proven to mediate the effect between ESG and company value.

Keywords: *ESG, Capital Structure, Enterprise Value*

Introduction

The development of the era makes the level of competition increasingly tight, thus requiring every company to have a competitive advantage. This competitive advantage is what creates value for the company so that it can grow and attract investors (Abigail et al., 2019). Companies that cannot survive will be left behind by their competitors so that the potential for making a profit is also getting smaller and can even go bankrupt (Romadlon & Suwaidi, 2022). Every company hopes that the value of its company will continue to increase and strives for this increase so that the company's performance can be assessed well by the owners and external parties who have an interest in the company (Dwiastuti & Dillak, 2019). To increase the value of the company, of course there are many factors that influence it, both internal and external. This factor is not only seen from the financial side, but the company also needs to pay attention to the non-financial side (Abigail et al., 2019).

One of the non-financial factors that must be considered in maximizing company value is by implementing environmental social governance (ESG). Environmental social governance (ESG) is one of the sustainability-based reporting and integrated reporting frameworks, both of which focus on expanding corporate reporting by including some non-financial information and are relatively voluntary (Igbinovia & Agbadua, 2023). Environmental social governance (ESG) is a set of standards designed to evaluate and regulate the environmental, social, and corporate performance of business companies. This is a way to evaluate a company's awareness or sense of responsibility for social welfare, environmental protection, and economic progress (Escrig-Olmedo et al., 2019). Environmental damage causes an imbalance in the environmental balance and has a negative impact (Sugiarto & Gabriella, 2020).

In Indonesia, the Indonesia Stock Exchange (IDX) has introduced the IDX ESG Leaders Index as an effort to encourage sustainable business practices. This index consists of companies that have high ESG scores based on assessments from independent institutions such as Sustainalytics. Companies included in this index are expected to have good ESG performance and can be a reference for investors who prioritize sustainable investment. Sustainability reporting studies are needed because the global climate change crisis is becoming increasingly urgent and is causing greater economic concerns for poor countries with underdeveloped systems and infrastructure (Gunawan & Sjarief, 2022). Although Indonesia is a developing country with high biodiversity, the ecological level in this country continues to decline, causing concern. The implementation of environmental management is needed to limit the use of natural resources and air emissions (carbon emissions, greenhouse gas impacts, and other compounds that damage the ozone layer), waste disposal, and biodiversity conservation. Therefore, to reduce the negative impact on the environment, strong environmental management procedures are needed in company operations (Xaviera & Rahman, 2023).

Air pollution in Indonesia is a serious problem that affects the quality of life of the population. Based on the 2021 World Air Quality Report, released in March 2022, Indonesia ranked 17th in the category of countries with the highest levels of air pollution. The report also noted that Indonesia ranked first in Asia for its highest levels of pollution. The second-largest contributor to carbon dioxide emissions came from the industrial sector, accounting for 24%, after the electricity sector, which accounted for 44% (Indonesian Cabinet Secretariat, 2023). The Center of Economic and Law Studies (Celios) revealed that the impact of high levels of air pollution is a decrease in investment interest. This phenomenon proves that the impact of industrial activities on the environment excessively can weaken the value of the company (Rahelliamelinda & Handoko, 2024). When companies protect the environment through environmentally friendly resources and practices and regulate the effectiveness of ESG practices, they can have a better role in achieving the SDGs (Ngo et al., 2022). The goal of sustainable development efforts that have been planned for a sustainable agenda, namely in 2030, is known to be interconnected and interdependent with regard to environmental, social and corporate management efforts (Khaled et al., 2021).

One of the challenges in sustainable development is the effort to preserve natural resources. Therefore, the Indonesia Stock Exchange (IDX) encourages business actors in Indonesia to implement Environmental, Social, and Governance (ESG) Disclosure, which means environmental, social, and governance aspects, in an effort to support sustainable finance in the capital market. Sustainability reporting studies are needed because the urgency of climate change is increasing worldwide. This is because developing countries with weak systems and infrastructure face greater economic threats.

According to research conducted by (Jeanice & Kim, 2023) states that companies usually believe that cost savings in environmental programs can provide greater customer advantages or satisfaction in the relationship between investment financial performance and environmental management. Conversely, if companies invest in poor environmental management, either due to inefficiency or unnecessary investment, business performance will be negatively impacted.

In addition to ESG, the value of the company can also be determined by the capital structure. (Brigham, 2019) Capital Structure is a comparison or balance of the company's long-term funding indicated by the comparison of long-term debt to equity. Research conducted by (Nurmala et al., 2023) this study applies the trade-off theory by examining the benefits of increasing debt, which is known to be high compared to the sacrifices made, thus relating to the benefits of applying debt in a way that can directly increase the value of the company. The increase in the value of the company is due to the increase in the amount of debt because the company's management uses debt as an effort to explain the business within the company. As related to the phenomenon that has been explained in this study, which provides a statement that is related to indications of good working capital management, namely related to working capital efficiency which can be seen from a form of capital turnover with cash assets owned by investment efforts in a component of working capital related to working capital turnover, turnover regarding inventory owned, turnover related to receivables. However, the study conducted by (Zidane & Suwarti, 2022) With an increase in capital structure, the company's value will decrease. If the company uses a large amount of debt, it will increase the risk which will result in debt becoming more expensive. This is in line with the signal theory which can give a bad signal to investors. Because the greater the debt used for the company's operational activities will increase financial risk, which in turn will reduce the profit received by the company and ultimately reduce its value. The above facts show that every company tries to maximize everything they have in their business activities to maintain the value of their company.

Capital structure, which reflects the proportion of debt and equity in corporate financing, also plays an important role in determining corporate value. The use of debt can provide tax benefits, but also increases the risk of bankruptcy. An optimal capital structure can maximize corporate value. Several previous studies have examined the relationship between ESG, capital structure, and corporate value. For example, research by (Ida Ayu Putu & Devi, 2024) This study presents that ESG teaches a negative impact on the value of a company, while related to the capital structure which is known to have a positive impact on the value of a company for companies listed on the IDX ESG Leaders in the period 2020 to 2022. However, the results of this study present an inconsistent phenomenon, so that further research efforts are needed to understand the relationship between the variables studied, especially for companies listed on the index.

With the background described above, this study aims to analyze the impact of ESG on company value through capital structure in companies listed on the IDX ESG Leaders Index. This study is expected to contribute to the development of literature on ESG and capital structure, as well as provide practical implications for companies and investors in decision making related to ESG practices and capital structure.

Theoretical Framework

Stakeholder Theory

Stakeholder theory states that companies must consider the interests of all parties involved or affected by their activities, not just shareholders. According to (Freeman & Mcvea, 2001), Stakeholders are understood as each group or group of individuals or individuals who are known to be able to present an influence or can gain influence on the achievement of organizational goals. It can be understood that the company bears the responsibility to be able to consider the needs and interests of related parties, such as employees, customers, communities, suppliers, and the surrounding environment at the point of stakeholder theory trying to explain that the company is known not only has responsibility to shareholders or investors, but also is responsible to all stakeholders, companies that are known to try to pay attention to aspects that are sustainable and good governance will bring more support from stakeholders, ultimately being able to realize public trust and the realization of long-term value.

Legitimacy Theory

Legitimacy theory states that organizations continually strive to ensure that they operate within the boundaries and norms of the society in which they operate (Deegan, 2002). Legitimacy theory states that companies must operate within boundaries and norms that are acceptable to society in order to continue to exist. ESG (Environmental, Social, and Governance) is used as a means to demonstrate that a company cares about social and environmental issues. Thus, ESG becomes a legitimacy tool that strengthens a company's reputation and reduces social and regulatory risks.

Trade-Off Theory

Trade-Off Theory or compromise theory explains that companies determine the optimal capital structure by considering the balance between the tax benefits of using debt (tax shield) and the costs incurred by using the debt, such as bankruptcy costs and agency costs (Kraus & Litzenberger, 1973). This theory assumes that there is no completely ideal capital structure without risk, so companies must compromise between their advantages and disadvantages.

In the context of Environmental, Social, and Governance (ESG), the Trade-Off Theory becomes more complex. The implementation of ESG practices affects the capital structure because companies must adjust their financial strategies with considerations of social responsibility and sustainability. Companies with high ESG performance are generally associated with lower bankruptcy risk, higher levels of investor confidence, and better access to funding (Nguyen & Nguyen, 2020).

However, the implementation of ESG principles also requires a significant initial investment cost, such as waste management costs, use of clean energy, workforce training, and governance reform. Therefore, companies need to make a trade-off between the cost of implementing ESG and its long-term benefits to financial stability and corporate value. Referring to the Trade-Off Theory, it can be concluded that companies will adjust their capital structure to remain efficient, considering traditional financial risks as well as non-financial factors such as sustainability and social legitimacy obtained through ESG implementation.

Signaling Theory

Signal Theory explains how internal parties of a company (management) try to reduce information asymmetry between them and external parties (such as investors, creditors, and other stakeholders) by sending signals through credible decisions or disclosures. This theory was first introduced by (Spence, 1973), who stated that:

"Signaling refers to activities by the informed party to credibly convey information to the uninformed party."

In the context of Environmental, Social, and Governance (ESG), signaling theory explains that ESG disclosure or sustainability reports are a form of signal from the company to the market and stakeholders. Companies that voluntarily and transparently disclose ESG performance are considered to be sending signals that they have good management, high risk awareness, and a long-term commitment to sustainability. This signal can improve the company's reputation, attract investors who care about sustainability (sustainable investors), and ultimately increase the company's value.

Furthermore, in conditions of intense competition and increasing public attention to ESG issues, this kind of signal is important to distinguish companies that are truly responsible from companies that are just greenwashing.

Relationship Between Variables

Effect of ESG on Capital Structure

Companies with good ESG performance tend to have lower risks (e.g. litigation risk, reputation risk), so they can gain access to financing at lower costs (cost of debt). This allows them to more freely manage their capital structure, for example with an optimal debt proportion.

Hypothesis 1: ESG affects capital structure because companies that pay attention to ESG have lower risks and better access to capital markets.

Effect of Capital Structure on Firm Value

Optimal capital structure (efficient composition of debt and equity) can maximize firm value. If a firm has a capital structure that is too aggressive (lots of debt), financial risk increases; if it is too conservative, the firm loses leverage opportunities.

Hypothesis 2: Capital structure affects firm value because it reflects funding efficiency and financial risk.

The Influence of ESG on Firm Value through Capital Structure

ESG can indirectly influence firm value through capital structure. In other words, ESG increases the credibility of the firm, reduces risk, and facilitates access to financing, which then results in an efficient capital structure and has an impact on increasing firm value.

Hypothesis 3: Capital structure mediates the influence between ESG and firm value.

Research Conceptual Framework

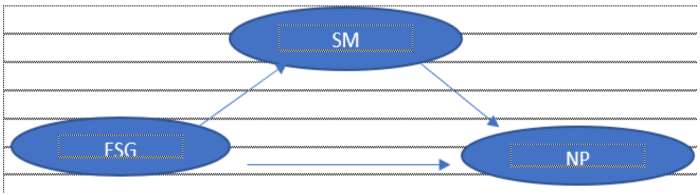

Figure 1. Research Concept Framework

Methods

This research is a quantitative research with a causality approach to test the effect of ESG on company value through capital structure. Data collection uses documentation. The data sources used are secondary data from annual reports and IDXLeader. The population in this study are companies listed in the IDX ESG Leaders Index during the 2020–2024 period. Sample selection was carried out purposively with the following criteria:

1. Companies that are consistently listed in the IDX ESG Leaders Index during the research period.
2. Companies that have complete data related to ESG, capital structure, and company value.

From these criteria, a sample of 14 companies was obtained in the 2021-2024 period so that the sample collected was 56. Each variable is measured using the following indicators:

Table 1. Operational Definition of Variables

Variabel	Formula
<u>Eksogen</u> ESG (X)	ESG Score
<u>Mediasi</u> Struktur Modal	$\text{DER} = \frac{Total\ Liabilities}{Total\ Ekuitas} x100\%$
<u>Variabel Endogen</u>	$Tobin\ 's\ Q = \frac{Total\ Market\ Value + Total\ Book\ Value\ of\ Liabilities}{Total\ Book\ Value\ of\ Asset}$

Variabel	Formula
Nilai Perusahaan	

Source: Processed data, 2025

This study used Partial Least Squares Structural Equation Modeling (PLS-SEM) analysis to test the relationship between latent variables. The model consists of exogenous, endogenous, and mediating variables. Several variables in the model have a single indicator (single-item construct), which is objective data that directly represents the construct, such as ratio data or ESG indexes that are measured in a standard way. Based on the guidelines from (Hair et al., 2021), constructs with one indicator do not require outer model testing such as convergent validity (AVE) and composite reliability, because there is no measurement model that can be tested. Therefore, variables with a single indicator are directly entered into the structural model (inner model) to analyze their influence.

Results and Discussions

Descriptive Statistics

Table 2. Descriptive Statistics

Variabel	Mean	Min	Max	Standard deviation
ESG	21.369	10.96	29.71	5.368
Struktur Modal	213.496	0.27	687.9	253.899
Nilai Perusahaan	1.717	0.641	10.57	1.965

Source: Smart PLS, 2025

Environmental, Social, and Governance (ESG) has a mean of 21.369 with a minimum value of 10.96 and a maximum value of 29.71. The standard deviation of 5.368 indicates moderate variation in ESG practices and disclosures between companies in the research sample. This fairly varied ESG value indicates that the level of compliance or implementation of sustainability aspects differs between companies.

Capital Structure, as measured by the DER ratio, has a mean of 213.496, with a minimum value of 0.27 and a maximum of 687.90. The standard deviation of 253.899 indicates very high dispersion, indicating the presence of companies with very aggressive capital structures (high debt levels) and companies with conservative capital structures. This high variation reflects differences in financing strategies between companies.

Firm Value, which can be measured using ratios such as Tobin's Q or Price to Book Value (PBV), has an average of 1.717, with a minimum value of 0.641 and a maximum of 10.57. With a standard deviation of 1.965, there is quite a high diversity in firm value. This shows that some companies are able to create a market value that is much greater than their book value, while others are in a low market value position.

Inner Model

Based on the results of data processing using SmartPLS, outer model testing was carried out for variables with two or more indicators. Meanwhile, in this study, the variable only has one indicator, so its validity and reliability were not tested, in accordance with the guidelines (Hair et al., 2021). These variables are considered theoretically valid because they are measured using objective data (eg DER ratio), which has been widely used in previous studies as a representation of the construct.

The relationship between the structural model of the Exogenous variables as a whole and the Endogenous variables is known using the results of the R-squared value

Table 3. R Square Value

	R-square	R-square adjusted
NP	0.060	0.024
SM	0.077	0.060

Source : Smart PLS, 2025

From the table above, it can be seen that the R-Square result of 0.060 or 6% indicates that the independent variable, namely ESG, in this research model is able to influence the dependent variable, namely Tobins Q Company Value by 6%, while other factors influence the remaining 94%. While the Capital Structure which acts as an Independent variable in its structure as an intervening variable produces an R Square of 0.077 or 7.7% meaning that the Capital Structure is influenced by ESG by 7.7% while other factors influence the remaining 92.3%.

Hypothesis Testing

Hypothesis testing with the smart PLS program can be seen from the results of the P-Value and T-Statistics. The testing criteria are said to have a relationship between the Independent variable and the Dependent variable from the P-Value <0.05 and T Statistics> 1.96

Hypothesis testing in Table 4 can be explained as follows:

Table 4. Results of Direct Effect Hypothesis Testing

Variabel	T statistics	P values
ESG -> NP	1.36	0.17
ESG -> SM	2.33	0.02
SM -> NP	2.23	0.03

Source : Smart PLS, 2025

Based on Table 4, it can be concluded that:

Company Value cannot be influenced by ESG disclosure, this is evidenced by the T Statistic Value of 1.36, which is less than 1.96 and the P value of 0.17, which is more than 0.05, meaning that ESG disclosure has an insignificant impact. It can be interpreted that ESG has no effect on Company Value so that H1 is Rejected. The companies in this study may have made formal ESG disclosures, but have not reflected substantial implementation quality. This is in line with the argument (Diouf & Boiral, 2017) that many companies still carry out ESG as a form of symbolic compliance, not as a managerial strategy oriented towards creating long-term value. Symbolic disclosures tend not to be able to increase investor confidence or market perception of company value. In the context of emerging markets such as Indonesia, investor awareness of sustainability issues is also still relatively low. As stated by (Fernando et al., 2017), ESG values are often not considered as the main factor in investment decision making, especially by retail investors. Investors tend to focus more on short-term financial performance than long-term sustainability, so ESG signals are not strong enough to increase company valuations.

Capital Structure is influenced by ESG disclosure, this is evidenced by the T Statistic Value of 2.33, which is more than 1.96 and P value 0.02 less than 0.05, meaning that ESG Disclosure has a significant impact. It can be interpreted that ESG influences capital structure so that H2 is Accepted. This finding indicates that companies with good ESG disclosure tend to have a more optimal or efficient capital structure. Based on the Trade-Off Theory, companies balance the benefits of using debt (tax shield) and the risk of bankruptcy (financial distress). In the context of ESG, companies with good sustainability practices are considered to have a lower risk by creditors, because they are better able to manage environmental, social, and governance issues. Low environmental risk, stable social relations, and transparent governance make companies considered more credible in meeting their debt obligations. Thus, ESG practices allow companies to access debt financing more cheaply or more easily, which ultimately affects the composition of their capital structure.

According to Signaling Theory, companies use information such as ESG to send positive signals to the market and creditors. Strong ESG disclosure can be seen as a signal that the company is professionally managed, transparent, and long-term oriented. This creates a positive perception that can increase the confidence of investors and financial institutions in providing funds. In other words, ESG improves the company's reputation in the eyes of capital providers, allowing them to choose a more flexible or higher-leverage capital structure without significantly increasing financial risk.

Based on Legitimacy Theory, it explains that companies try to gain legitimacy from society and stakeholders through actions that are considered in accordance with social norms and values. In this case, companies that actively disclose and implement ESG are considered to be carrying out their roles socially and ethically, thus gaining support from stakeholders, including financial institutions. This legitimacy can reduce external pressure, strengthen relationships with institutional investors, and facilitate access to long-term funding sources with a more flexible capital structure.

The company value is influenced by the capital structure, this is evidenced by the T Statistic Value of 2.33 which is more than 1.96 and P value 0.03 less than 0.05, meaning that the capital structure has a significant impact. It can be interpreted that the capital structure affects the company value so that H3 is accepted. This finding is in line with the Trade-Off Theory (Kraus & Litzenberger, 1973), which states that companies will seek an optimal capital structure by considering the balance between the benefits of using debt (tax shield) and bankruptcy costs. When companies are able to manage debt efficiently, the use of moderate debt can increase the company's value because it reduces the tax burden through interest tax deductions, Provides managerial discipline due to the existence of fixed payment obligations (monitoring by creditors), Increases financial leverage which can raise return on equity (ROE).

Based on Signaling Theory (Spence, 1973), the choice of a particular capital structure, especially the use of debt, can be a positive signal that management is confident about future earnings prospects. Debt reflects a commitment to pay fixed obligations, which can only be done if management is confident about future cash flows. In this study, companies with a strong and healthy capital structure may be successful in sending this signal to the market, thereby increasing the perception of low risk and high return expectations, which leads to an increase in the company's value. In this context, the right capital structure is a signal of financial efficiency, which increases investor confidence and strengthens market valuation. In the Indonesian capital market, investors often use capital structure indicators (such as DER) as a measure of a company's prudence and financial stability. A capital structure that is too conservative (relying solely on equity) can indicate inefficiency. Conversely, a moderate and balanced capital structure is considered a form of optimizing financial resources, which can increase the company's value in the eyes of investors.

Table 5 Results of Indirect Effect Hypothesis Test

Variabel	T statistics	P values
ESG -> SM -> NP	1.56	0.12

Source : Smart PLS, 2025

The hypothesis testing of the indirect relationship between exogenous variables, intervening variables and endogenous variables in Table 5 can be explained as follows

Company Value cannot be influenced by ESG through Capital Structure. This is evidenced by the T Statistic Value of 1.56 which is less than 1.96 and the P value of 0.12 greater than 0.05, meaning that ESG does not have a significant impact on Company Value through Capital Structure. It can be interpreted that ESG does not affect Company Value through capital structure mediation so that H3 is Rejected. This finding indicates that although ESG has a direct effect on capital structure (as evidenced by the results of previous tests), the influence does not continue to increase company value through the capital structure mechanism. The market has not fully appreciated ESG practices as a long-term value signal, especially in developing markets such as Indonesia, where investors focus more on conventional financial indicators. In the context of Trade-Off Theory, although ESG can affect capital structure (for example by reducing risk and facilitating access to financing), not all capital structure decisions will immediately have an impact on company value—especially if the market has not yet assessed ESG as a competitive advantage. Legitimacy Theory also suggests that ESG can enhance corporate legitimacy, but this legitimacy may have more impact on social stakeholders and regulators than directly influencing financial structures that increase market valuations.

Based on the results of the analysis using the Partial Least Squares Structural Equation Modeling (PLS-SEM) method, several important findings were obtained as follows:

1. ESG does not have a significant effect on company value directly, as indicated by a T statistic value of 1.36 (less than 1.96) and a P value of 0.17 (more than 0.05). Thus, the first hypothesis (H1) is rejected.
2. ESG has a significant effect on capital structure, as evidenced by a T statistic value of 2.33 (more than 1.96) and a P value of 0.02 (less than 0.05). Therefore, the second hypothesis (H2) is accepted. This shows that a company's ESG practices can influence the financing strategy or capital structure taken by the company.
3. Capital structure has a significant effect on company value, with a T statistic value of 2.33 and a P value of 0.03. The third hypothesis (H3) is accepted, which means that the more optimal the capital structure, the higher the company's value.
4. ESG does not have a significant effect on company value through capital structure as a mediating variable. This is evidenced by the T statistic value of 1.56 (less than 1.96) and P value of 0.12 (more than 0.05). Therefore, the fourth hypothesis (H4) is rejected.

Thus, the results of this study confirm that although ESG can influence a company's capital structure policy, its influence on company value - both directly and indirectly - has not been proven significant in the context of this study.

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