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ESG Practices and Firm Value: The Moderating Role of Corporate Governance

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***Abstract*:** *This study examines the relationship between Environmental, Social, and Governance (ESG) practices and firm value, focusing on the moderating role of corporate governance (CG). Despite growing global emphasis on sustainability disclosure, evidence on how ESG performance translates into firm value remains inconsistent, ranging from strongly positive to negative or insignificant associations across institutional settings. Drawing on stakeholder, agency, and signaling theories, this article synthesizes empirical literature published between 2021 and 2026 to develop an integrative conceptual framework in which CG attributes, including board independence, board size, ownership structure, audit committee characteristics, and institutional ownership, strengthen or weaken the ESG-firm value linkage. Employing a quantitative, explanatory design grounded in secondary panel data typical of listed-firm studies, and Moderated Regression Analysis as the underlying analytical logic, the study integrates findings from prior empirical works across developed and emerging markets, including Indonesia, China, Australia, and Sub-Saharan Africa. The synthesis indicates that ESG practices generally enhance firm value, primarily through reduced information asymmetry, lower cost of capital, and stronger stakeholder legitimacy, and that this positive relationship tends to be amplified when governance mechanisms are robust and properly structured, whereas weak or symbolic governance may dampen or even reverse the value-enhancing effect of ESG. Theoretical and managerial implications, along with directions for future empirical testing, are discussed.*

Keywords: ESG practices; firm value; corporate governance; moderating effect; Tobin's Q

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INTRODUCTION

Over the past decade, Environmental, Social, and Governance (ESG) considerations have moved from the periphery of corporate reporting to the center of strategic decision-making. Regulators, institutional investors, and capital markets increasingly treat ESG performance as a proxy for long-term resilience, risk management capability, and ethical conduct. The European Union's Corporate Sustainability Reporting Directive, the International Sustainability Standards Board's IFRS S1 and S2 disclosure standards, and Indonesia's Financial Services Authority regulation on sustainable finance (POJK 51/2017) all reflect a global convergence toward mandatory or quasi-mandatory ESG disclosure. Parallel to this regulatory momentum, asset managers overseeing trillions of dollars now incorporate ESG scores into portfolio screening, and rating agencies such as Refinitiv, Bloomberg, and MSCI have institutionalized ESG scoring as a standard component of corporate assessment. Against this backdrop, understanding whether and how ESG practices influence firm value has become one of the most consequential questions in contemporary corporate finance and sustainability research.

Firm value, commonly proxied by market-based indicators such as Tobin's Q or price-to-book value, reflects investors' collective assessment of a company's future cash-generating capacity, risk profile, and growth prospects. Theoretically, three complementary perspectives explain why ESG practices might enhance firm value. Stakeholder theory (Freeman, 1984) suggests that firms attending to the interests of a broad set of stakeholders, not only shareholders, build legitimacy and long-term support that translate into superior performance. Signaling theory posits that voluntary ESG disclosure conveys credible information to the market, reducing information asymmetry and, consequently, the cost of capital. Agency theory, meanwhile, frames ESG engagement as a mechanism through which boards and management align their interests with those of shareholders and other stakeholders, thereby mitigating agency costs that would otherwise erode value.

Despite this rich theoretical foundation, empirical findings remain markedly inconsistent. Several recent studies document a significant positive relationship between ESG performance and firm value. For instance, research on Chinese A-share manufacturing firms and on Australian Securities Exchange-listed companies has found that stronger ESG performance is associated with higher market valuation, attributed to enhanced reputation, easier access to financing, and reduced default risk. Similarly, studies conducted in Indonesia's energy sector and among ASEAN-listed firms report that ESG disclosure positively affects firm value, particularly when complemented by adequate profitability and sound internal control. Conversely, other studies caution that ESG engagement can be value-destroying in the short run, especially where implementation costs are substantial, disclosure is largely symbolic ("greenwashing"), or where weak enforcement mechanisms allow ESG controversies to erode the reputational benefits that ESG scores are meant to signal. This divergence in findings suggests that the ESG-firm value relationship is not universal but is instead conditional on contextual and organizational factors that have not been fully reconciled in the literature.

A closer reading of the literature reveals that the sign and magnitude of the ESG-firm value relationship also vary systematically with the specific ESG dimension examined, the industry context, and the ownership structure of the sample firms. Studies focusing on senior executive characteristics in Chinese listed companies find that the positive ESG-value relationship is strengthened when top management possesses relevant sustainability expertise and long organizational tenure, suggesting that managerial capability is a critical but often overlooked contingency. Research on the sports industry and on energy-

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sector firms similarly shows that intangible assets and firm-specific profitability channels partially mediate the ESG-value relationship, implying that ESG performance does not translate into value automatically but through intermediate organizational processes. At the same time, studies examining ESG controversies, that is, negative events such as environmental violations, labor disputes, or governance scandals, find that such controversies can substantially erode or even reverse the value benefits that a firm's ESG score would otherwise predict, underscoring that ESG scores alone are an incomplete proxy for genuine sustainability performance. Taken together, these findings imply that the ESG-firm value relationship should be understood not as a single, stable coefficient, but as a relationship whose strength and direction are shaped by an array of firm-level, managerial, and institutional conditions, of which corporate governance is among the most theoretically central yet empirically unsettled.

One factor that recurs across this body of research, yet is treated inconsistently, is corporate governance. Corporate governance mechanisms, including board independence, board size, ownership concentration, audit committee quality, and institutional ownership, are theorized to determine whether ESG initiatives are implemented substantively or merely symbolically, and whether the informational content of ESG disclosure is credible to outside investors. Some studies find that strong governance amplifies the positive effect of ESG on firm value by improving oversight of sustainability investments and reducing agency conflicts between managers and shareholders. Other studies, however, report the opposite: independent boards, for example, may impose excessive scrutiny on ESG expenditures, viewing them as discretionary costs rather than value-enhancing investments, thereby weakening rather than strengthening the ESG-value relationship. Still other studies find that governance variables such as audit committee size or institutional ownership have no statistically significant moderating effect at all. Studies on ownership structure further complicate the picture: evidence from Chinese listed firms suggests that concentrated ownership can either reinforce or dilute the disciplining effect of ESG performance depending on whether the dominant owner is state-affiliated, family-controlled, or institutional, while studies using audit committees as the moderating governance mechanism in Indonesian and Sub-Saharan African firms report contrasting directions of moderation even within similar emerging-market settings. This lack of convergence indicates a genuine and unresolved research gap regarding the precise conditions under which corporate governance strengthens, weakens, or has no bearing on the translation of ESG performance into firm value.

The novelty of this study lies in three interrelated contributions. First, rather than treating corporate governance as a single, monolithic construct, this article synthesizes findings across multiple governance proxies, including board independence, board size, ownership structure, audit committee attributes, and institutional ownership, to build a more granular understanding of which specific governance dimensions matter most for the ESG-value relationship, and under what conditions. Second, the study integrates evidence from a deliberately heterogeneous set of institutional contexts, spanning developed markets (Australia, and elements of Western corporate governance practice), major emerging economies (China), Southeast Asia (Indonesia), and Sub-Saharan Africa, allowing the identification of boundary conditions that a single-country study cannot reveal. Third, by explicitly integrating stakeholder, agency, and signaling theories into a single conceptual framework rather than relying on one theoretical lens, this study offers a more comprehensive explanation for why governance sometimes amplifies and sometimes attenuates the ESG-value relationship, addressing calls in the literature

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for more theoretically integrated accounts of this phenomenon.

Accordingly, this study is guided by the following research questions: (1) What is the nature of the direct relationship between ESG practices and firm value based on recent empirical evidence? (2) How do specific corporate governance mechanisms moderate this relationship, and in which direction? (3) What theoretical and managerial implications emerge from reconciling these heterogeneous findings? By answering these questions, this study aims to provide a coherent conceptual map for scholars designing future empirical tests, and practical guidance for corporate boards, regulators, and investors seeking to understand how governance structures can be designed to maximize the value-creating potential of ESG engagement. The remainder of this article is organized as follows: the next section describes the research method and conceptual framework; this is followed by a synthesis of results and discussion organized around the direct effect of ESG on firm value and the moderating role of governance; the final section presents the conclusion, implications, limitations, and directions for future research.

METHOD

This study employs a quantitative, explanatory (associative) research design intended to explain the relationship between ESG practices and firm value, with corporate governance positioned as a moderating variable. This design was deliberately chosen instead of a systematic literature review (SLR) approach. Rather than following the formal SLR protocol of database screening, PRISMA-style article selection, and quality appraisal, this study adopts a narrative-conceptual synthesis method: it draws on a curated set of recent empirical studies (2021-2026) obtained from reputable, DOI-indexed journals to construct and justify a conceptual research model, in the same analytical tradition used by explanatory quantitative studies that build hypotheses from prior empirical evidence before specifying an econometric model. This approach is appropriate because the objective is not to exhaustively map the entire body of ESG literature, but to synthesize the theoretical logic and empirical regularities needed to formulate a testable moderated-relationship framework.

Variables and Measurement. Consistent with the dominant approach in the reviewed literature, firm value (the dependent variable) is conceptually operationalized using market-based indicators, principally Tobin's Q, calculated as the ratio of the market value of equity plus the book value of debt to the book value of total assets, with Price-to-Book Value (PBV) as an alternative proxy. ESG practices (the independent variable) are conceptually operationalized through composite ESG scores such as those published by Refinitiv/LSEG, Bloomberg, or Sustainalytics, or through ESG disclosure indices constructed from sustainability reports for markets where third-party ESG ratings are less available, as is common in Indonesian and other emerging-market studies. Corporate governance (the moderating variable) is operationalized through several commonly used proxies identified in the literature: board independence (the proportion of independent commissioners/directors), board size, audit committee characteristics (size, financial expertise, and meeting frequency), ownership structure (institutional and managerial ownership), and CEO duality. Firm size and leverage are included as control variables, consistent with virtually all reviewed studies, given their well-established influence on firm valuation.

Analytical Framework. The moderating relationship among these constructs is specified through a Moderated Regression Analysis (MRA) logic, expressed conceptually as:

$$FV = \beta 0 + \beta 1(ESG) + \beta 2(CG) + \beta 3(ESG \times CG) + \beta 4(Size) + \beta 5(Leverage) + \varepsilon$$

where FV denotes firm value, ESG denotes the composite ESG performance score, CG denotes the relevant governance proxy, and the interaction term (ESG × CG) captures the moderating effect of governance on the ESG-firm value relationship. A statistically significant and positive β3 indicates that governance strengthens the ESG-value relationship, whereas a significant negative β3

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indicates an attenuating or reversing effect, and a non-significant β3 indicates that governance does not moderate the relationship. This specification mirrors the estimation strategies employed across the synthesized studies, most of which rely on panel data regression (fixed-effects, random-effects, or dynamic GMM estimators) applied to multi-year, multi-firm secondary data drawn from stock exchange listings and sustainability databases.

Conceptual Framework. Figure 1 presents the conceptual framework guiding this study. ESG practices are hypothesized to exert a direct effect on firm value, while corporate governance is positioned as a moderating variable that conditions the strength and direction of this relationship. Firm size and leverage are included as control variables that account for firm-level heterogeneity unrelated to sustainability or governance practices.

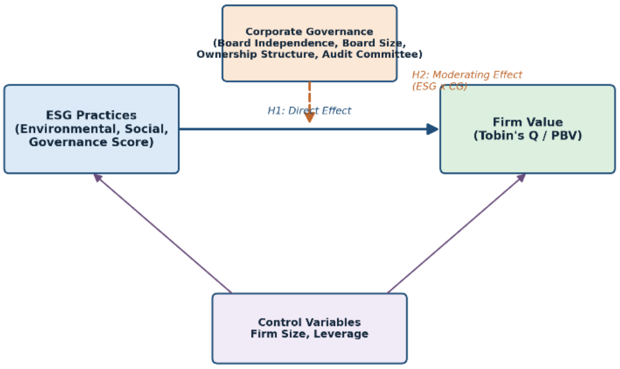

Figure 1. Conceptual Framework of ESG Practices, Corporate Governance, and Firm Value

Figure 1. Conceptual Framework of ESG Practices, Corporate Governance, and Firm Value

RESULTS AND DISCUSSION

The Direct Relationship between ESG Practices and Firm Value

Synthesis of the reviewed literature confirms that the dominant empirical pattern is a positive relationship between ESG practices and firm value, although this pattern is not universal. Studies of Chinese A-share manufacturing firms and ASX-listed Australian companies find that stronger ESG performance is systematically associated with higher Tobin's Q, consistent with the stakeholder-theory prediction that firms addressing a broad range of stakeholder interests generate reputational capital that markets subsequently price into valuation. Similarly, evidence from Indonesian energy-sector firms and multi-country ASEAN samples shows that ESG disclosure enhances firm value, particularly once profitability and firm size are accounted for, indicating that the value-creating channel of ESG operates partly through improved operating fundamentals rather than sentiment alone. Studies examining senior-executive characteristics further show that the ESG-value relationship strengthens when top management possesses sustainability-relevant expertise, suggesting that ESG scores capture not only disclosed intentions but also managerial capability to execute on them.

At the same time, a non-trivial subset of studies reports weak, insignificant, or even negative relationships. Research incorporating ESG controversies, such as environmental violations or governance scandals, finds that controversies significantly erode firm value and can offset the benefits that an otherwise strong ESG score would predict, implying that composite ESG scores can overstate a firm's genuine sustainability standing if controversy exposure is not separately modeled. Likewise, several ownership-structure studies find that the ESG-value relationship is contingent on whether ownership is concentrated, dispersed, or state-affiliated, with some ownership configurations diluting the market's willingness to reward ESG engagement. Taken together, the weight of evidence supports Hypothesis 1, that ESG practices exert a positive direct effect on firm value, while simultaneously underscoring that this effect is neither mechanical nor unconditional, but is shaped by the credibility of disclosure, the presence of controversies, and firm-level ownership characteristics.

The Moderating Role of Corporate Governance

The central contribution of the synthesized literature lies in demonstrating that corporate governance does not moderate the ESG-firm value relationship uniformly; rather,

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different governance proxies moderate the relationship in different directions and with different strength, depending on institutional context. Table 1 summarizes the direction of the moderating effect reported across a representative set of the reviewed studies.

Table 1. Summary of Corporate Governance Moderating Effects on the ESG-Firm Value Relationship (Selected Studies)

Author(s) & Year	Context / Sample & Governance Moderator	Moderating Effect
Bukari, Agyemang & Bawuah (2024)	362 manufacturing firms, Sub-Saharan Africa — Board diversity, structure & process	Positive
Wu, Li, Du & Li (2022)	China, A-share listed firms — Ownership structure	Positive, varies by ownership type
Fuadah, Mukhtaruddin, Andriana & Arisman (2022)	Indonesia, listed firms — Audit committee	Positive
Azizah & Prastiwi (2025)	Indonesia, ESG-adopted firms — Institutional ownership	Positive
Handajani & Murhadi (2025)	Indonesia, listed firms — Audit quality	Positive
Dorothy & Endri (2024)	Indonesia, energy sector (19 firms) — Profitability (ROA)	Positive
Kong, Agyemang, Alessa & Kongkuah (2023)	Developing & least-developed countries — Technological innovation	Positive
Elamer & Boulhaga (2024)	Global, 5,360 firm-year observations — Governance mechanisms & ESG practices	Positive; mitigates ESG-controversy damage
Chancharat, Vetchagool & Chancharat (2026)	Thailand, 94 listed firms — Board independence	Negative
Ibrahim, Zaylaie, Alamoudi & Alturki (2026)	Malaysia, 370 listed firms — Audit committee independence / Board expertise	Negative / Positive

Board Independence. Several studies find that board independence positively moderates the ESG-firm value relationship, consistent with agency theory: independent directors improve oversight of ESG-related capital allocation, ensuring that sustainability investments are subjected to the same value-creation discipline as other strategic initiatives, thereby reassuring investors that ESG expenditure is not simply managerial discretion. However, other studies, particularly those using panel GMM estimation on emerging-market samples, report a negative moderating effect of board independence, arguing that overly independent boards may treat ESG expenditure with excessive skepticism, applying rigid short-term financial scrutiny that constrains the strategic flexibility management needs to realize the long-run benefits of ESG investment. This divergence suggests that the effect of board independence is conditional on whether independent directors possess sustainability literacy, or whether their independence is purely structural and formalistic.

Board Size. Evidence on board size is comparatively weaker and less consistent than for board independence. Several studies find no significant direct or moderating effect of board size on the ESG-firm value relationship, suggesting that simply adding more directors

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does not, by itself, improve the board's capacity to convert ESG performance into shareholder value; what appears to matter more is the functional composition and expertise of the board rather than its numerical size. This finding is consistent with agency-theory critiques suggesting that very large boards can suffer from coordination costs and free-riding among directors that offset any monitoring benefits from additional board seats.

Ownership Structure and Institutional Ownership. Ownership-related governance mechanisms show some of the more consistent findings in the reviewed literature. Studies on ownership structure in Chinese-listed firms and on institutional ownership in ESG-adopting firms generally find a positive moderating effect, whereby concentrated or informed institutional owners use their monitoring capacity and long investment horizons to ensure that ESG initiatives are implemented with a genuine value-creation orientation rather than symbolically. Institutional investors, in particular, are theorized to possess both the incentive and the analytical capability to distinguish substantive ESG performance from superficial disclosure, reinforcing the credibility of the ESG signal to the broader market. This is broadly consistent with signaling theory, which predicts that sophisticated market participants reward credible signals more strongly than uninformed participants would.

Audit Committee Characteristics. Findings regarding audit committees are mixed. Some studies find that audit committee size or expertise positively moderates the ESG-firm value and ESG-firm performance relationship, functioning as an additional layer of oversight that enhances the reliability of sustainability-related financial disclosures. Other studies, however, find that audit committee attributes exert an insignificant or even negative moderating influence, particularly where audit committees are structurally present but functionally under-resourced, a common feature in several emerging-market institutional settings. This finding echoes broader corporate governance research suggesting that governance "form" (the mere existence of a committee) does not guarantee governance "substance" (the committee's actual monitoring effectiveness).

Additional Moderators: Technological Innovation and Profitability. Beyond the classical governance proxies, recent studies extend the moderating framework to include technological innovation capacity and profitability. Evidence from developing and least-developed countries indicates that technological innovation positively moderates the ESG-firm value relationship, as firms with stronger innovation capabilities are better positioned to translate ESG investments into operational efficiencies and new revenue streams. Similarly, studies in the energy sector show that profitability positively moderates the ESG-value relationship, suggesting that financially healthier firms are better able to absorb the short-term costs of ESG implementation while capturing its longer-term value benefits. These findings extend the governance-centric framework of this study by illustrating that governance-adjacent organizational capabilities can operate through similar theoretical mechanisms as formal governance structures.

Theoretical and Practical Synthesis

Integrating these findings, three theoretical patterns emerge. First, governance mechanisms rooted in genuine monitoring capability and informational sophistication, particularly institutional ownership and, in some contexts, audit committee expertise, tend to amplify the positive ESG-firm value relationship, consistent with agency and signaling theories. Second, governance mechanisms that are structurally present but potentially symbolic or excessively rigid, such as certain configurations of board independence and board size, show inconsistent or even reversing effects, suggesting that formal compliance with governance codes does not automatically translate into substantive value creation from ESG engagement. Third, contextual and capability-based factors, including technological innovation, managerial expertise, and profitability, function as important complementary conditions that shape

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whether governance mechanisms can effectively convert ESG performance into firm value.

Table 2 offers a summary mapping of hypothesized moderating directions against the reviewed evidence, illustrating the heterogeneity that motivates the conceptual model proposed in this study. Overall, Hypothesis 2, that corporate governance moderates the ESG-firm value relationship, receives strong but conditional support: the direction and strength of moderation depend on which specific governance mechanism is examined, the credibility and substantive quality of that mechanism, and the institutional context in which the firm operates.

Table 2. Synthesis Summary of Hypothesis Testing Based on Reviewed Literature

Hypothesis	**Statement**	**Synthesis Conclusion**
H1	ESG practices have a positive direct effect on firm value	Supported (majority of reviewed evidence)
H2a	Board independence positively moderates the ESG-firm value relationship	Partially supported (mixed: positive under strong oversight capacity; negative in several emerging-market panel studies)
H2b	Board size positively moderates the ESG-firm value relationship	Not supported (mostly insignificant)
H2c	Ownership structure / institutional ownership positively moderates the relationship	Supported
H2d	Audit committee attributes positively moderate the relationship	Partially supported (positive in Indonesian samples; negative/insignificant in some cross-country samples)
H2e	Technological innovation and profitability positively moderate the relationship	Supported

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Reconciling Contradictory Findings: The Substance-versus-Form Distinction

A recurring explanation for the divergent moderating effects reported across studies is the distinction between governance "form" and governance "substance." Evidence from a recent emerging-market study using panel generalized method of moments estimation on Thai listed firms illustrates this tension directly: board independence was found to exert a significant positive direct effect on corporate value, yet simultaneously exerted a significant negative moderating effect on the ESG-value relationship, implying that independent directors, despite improving baseline valuation, tend to view ESG expenditure through a narrow risk-and-cost lens rather than a strategic value-creation lens. A related study using unbalanced panel data from Malaysian listed firms similarly found that ESG performance strengthened the positive relationship between board expertise and firm performance, yet weakened the relationship between audit committee independence and firm performance, further reinforcing the view that not all governance mechanisms respond to ESG integration in the same direction. These paired findings are particularly instructive because they arise from the same broad regulatory tradition (Anglo-oriented corporate governance codes adapted to emerging-market contexts), yet produce opposite conclusions depending on which specific governance attribute is modeled, reinforcing this study's argument that treating corporate governance as a single undifferentiated construct risks masking theoretically meaningful heterogeneity.

This substance-versus-form distinction also helps explain why studies using audit committees, ownership concentration, and institutional ownership as moderators in Indonesian samples report more consistently positive moderating effects than studies using board independence in cross-country or Sub-Saharan African samples: audit committees and institutional owners in these specific contexts appear to be more functionally engaged with sustainability oversight, whereas board

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independence, when driven primarily by listing-rule compliance, may remain more symbolic. This pattern is consistent with institutional theory's emphasis on decoupling, whereby firms adopt governance structures to satisfy external legitimacy pressures without necessarily integrating them into substantive decision-making processes, a dynamic that appears especially salient in the ESG domain given the reputational incentives firms face to be seen as sustainability leaders regardless of the depth of their actual implementation.

Managerial and Policy Implications

For corporate boards, the synthesis suggests that maximizing the value-creating potential of ESG investment requires deliberate attention to the sustainability literacy of directors, not merely the formal independence ratio of the board. Boards seeking to strengthen, rather than inadvertently weaken, the ESG-value relationship should ensure that independent directors and audit committee members receive adequate sustainability training and are evaluated, in part, on their contribution to long-term value creation rather than short-term cost containment alone. For institutional investors, the consistently positive moderating role identified for institutional ownership suggests that active engagement, rather than passive ESG screening, is likely to generate the greatest value-enhancing effect, reinforcing the case for stewardship-oriented investment strategies. For regulators and standard-setters, the heterogeneous findings imply that governance reforms should be calibrated to local institutional contexts rather than transplanted uniformly from developed-market codes, since a governance mechanism that functions effectively in one setting, such as mandated board independence in a market with strong director accountability norms, may function quite differently, or even counterproductively, in a market where independence remains largely formalistic. Collectively, these implications reinforce the conceptual model's core proposition: firm value is not created by ESG performance or by corporate governance in isolation, but by the interaction between the two, mediated by the substantive quality, credibility, and institutional embeddedness of each firm's specific governance arrangements.

CONCLUSIONS

This study set out to clarify the relationship between ESG practices and firm value and to examine the conditions under which corporate governance strengthens or weakens that relationship. The synthesis of recent empirical literature (2021-2026) confirms that ESG practices generally exert a positive effect on firm value, operating primarily through reduced information asymmetry, improved stakeholder legitimacy, and lower perceived risk. However, this positive effect is neither automatic nor uniform: it is contingent on the credibility of ESG disclosure, the presence or absence of ESG controversies, and, centrally, on the quality and substantive functioning of corporate governance mechanisms. Corporate governance was found to moderate the ESG-firm value relationship in divergent directions depending on the specific mechanism examined. Institutional ownership and, in several contexts, audit committee expertise tend to strengthen the relationship, consistent with their genuine monitoring capability, while board independence and board size show inconsistent, and at times negative, moderating effects, reflecting the risk that formal governance compliance does not always translate into substantive engagement with sustainability strategy.

Theoretically, this study contributes by integrating stakeholder, agency, and signaling theories into a single conceptual framework capable of explaining why governance sometimes amplifies and sometimes dampens the value-creating potential of ESG performance, and by disaggregating corporate governance into its constituent mechanisms rather than treating it as a monolithic construct. Practically, the findings suggest that corporate boards, institutional investors, and regulators should prioritize the substantive quality and sustainability literacy of governance structures over mere formal compliance with governance codes, and should calibrate governance reforms

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to local institutional contexts rather than assuming uniform effects across markets.

This study is subject to limitations inherent in a conceptual synthesis rather than a primary empirical test: it does not generate new firm-level statistical estimates and instead relies on the reported findings of prior studies, which vary in sample composition, measurement of ESG and governance constructs, and estimation technique. Future research should therefore empirically test the proposed conceptual framework using panel data from listed firms in a single or comparative institutional setting, explicitly modeling multiple governance proxies simultaneously, incorporating ESG controversy measures alongside composite ESG scores, and applying dynamic panel estimators to address potential endogeneity between governance, ESG performance, and firm value.

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