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ESG Disclosure, Political Connection, And Firm Value: An Empirical Analysis

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Abstract: This study aims to analyze the effect of ESG (Environment, Social, Governance) disclosure and political connections on firm value. The object of this study is companies listed on the Indonesia Stock Exchange and included in the Liquid 45 Index (LQ45) list in 2022-2024. ESG disclosure is measured based on the Global Reporting Initiative Standard checklist, while political connections are measured by the ratio between the members of the board of commissioners and directors who are politically connected to the total members of the board of commissioners and directors in the company. Meanwhile, firm value is measured using the Tobin's Q calculation method. This study uses a purposive sampling method with a sample of 39 companies. The analysis was conducted using panel data regression. The results of the study show that ESG disclosure and political connections have no effect on firm value, which indicates that sustainability signals and political affiliations have not been fully appreciated by the market as drivers of fundamental company value in the LQ45 index.

Keywords: ESG Disclosure, Political Connection, Firm Value, Tobin's Q, LQ45 Index

INTRODUCTION

Firm value is the investor's perception of the company's success rate, often associated with stock prices. In more depth, Husnan and Pudjiastuti (2015) define firm value as the price prospective investors are willing to pay if the company were sold as a whole. In line with this, Brigham and Houston (2019) state that for companies that have conducted an initial public offering (IPO) or gone public, firm value is reflected in the market value of its outstanding securities, where shareholder wealth increases linearly with rising share prices. Similarly, Sartono (2010) states that firm value is the selling value of a company as an operating, going-concern business, where achieving a high value serves as tangible evidence that management is able to manage the owners' wealth effectively and efficiently. Achieving a high firm value is a key strategic objective, as it reflects the maximization of shareholder wealth and the long-term sustainability of the business.

Along with growing global awareness, firm value today is determined not only by financial performance but also influenced by corporate responsibility toward non-financial aspects summarized in the environmental, social, and governance (ESG) concept. The ESG concept is based on the triple bottom line idea introduced by Elkington (1997), which states that a company's sustainability depends on the balance between profit (economic), people (social), and planet (environmental). In addition, legitimacy theory explains that companies carry out ESG disclosure to ensure that their activities operate within societal boundaries and norms, thereby gaining social recognition that supports business continuity (Suchman, 1995). From the resource-based view (RBV) perspective, ESG disclosure is regarded as an intangible asset that can provide firms with a competitive advantage through improved reputation and operational efficiency (Barney, 1991). Theoretically, based on signaling theory, comprehensive ESG disclosure functions as a credible signal regarding management quality and the firm's resilience to long-term risk. This signal reduces information asymmetry between management and investors, which in turn can lower the risk premium and cost of capital, thereby increasing the market's valuation of the firm (Fatemi et al., 2018). Furthermore, from the perspective of stakeholder theory, strong ESG disclosure builds social capital and trust, which act as a safeguard for firm value, particularly during periods of market volatility (Friede et al., 2015). The ultimate impact of this ESG signaling effectiveness is reflected in an increase in Tobin's Q, where the market assigns a higher value premium to companies with a low sustainability risk profile.

However, previous studies on the effect of ESG on firm value have shown inconsistent results. Research by Wu et al. (2024) and Hardiningsih et al. (2024) found that ESG performance has a significant positive effect on firm value. Conversely, research by Bashatweh et al. (2024) and Dinasti (2023) shows that aggregate ESG disclosure actually has no effect or even a negative effect on firm value. The inconsistency of these results indicates a research gap that needs to be bridged by including another variable, namely political connections. Within the framework of the resource-based view (RBV), political connections are considered an intangible strategic resource capable of providing a competitive advantage for companies through privileged access to various operational conveniences (Faccio, 2006). The selection of the LQ45 index as the research object is very important because these companies bear a greater burden of public expectations. As a barometer of the Indonesian capital market, LQ45 issuers are often pioneers in implementing new regulations, including the obligation to prepare sustainability reports based on POJK 51/2017. Given their high visibility and large operational scale, the ESG signals provided by companies in the LQ45 index have a systemic impact on global investors' perceptions of the maturity of the Indonesian capital market.

Signaling Theory. The signaling theory developed by Spence (1973) explains the behavior of entities in facing uncertainty. In a financial context, companies with good risk management quality provide "signals" to the market. ESG disclosure is seen as a credible signal because it requires high commitment and compliance, which can only be fulfilled by companies with mature risk management. On the other hand, political connections act as a strategic signal that informs the market about a company's exclusive access to governmental resources.

Stakeholder Theory. Introduced by Freeman (1984), this theory defines a company's success as measured by its ability to manage relationships with all parties that influence its goals. ESG disclosure is an accountability instrument to fulfill primary and secondary stakeholders' right to information, in accordance with the attributes of urgency and legitimacy they hold. On the other hand, the political connection variable represents strategic management of one of the most powerful primary stakeholders, namely the government.

Legitimacy Theory. This theory is based on the social contract between the company and society (Suchman, 1995). ESG disclosure is a proactive corporate strategy to align corporate values with societal values in order to maintain the social contract. By transparently

reporting environmental and social performance, companies seek to close the legitimacy gap and strengthen their moral legitimacy in the eyes of investors. On the other hand, political connections can also be viewed as a tool for obtaining administrative and political legitimacy from the government as the primary regulator.

Hypothesis Development

Empirical research conducted by Hardiningsih et al. (2024) and Zhou et al. (2025) provides consistent evidence that environmental, social, and governance (ESG) disclosure makes a positive contribution to increasing firm value.

H1: Environmental, social, and governance (ESG) disclosure has a positive effect on firm value.

Empirical support for the role of political connections in market valuation is found in the studies of Hardiningsih et al. (2024) and Joseline et al. (2021), which show that politically connected companies tend to have higher market values.

H2: Political connection has a positive effect on firm value.

METHODS

Population & Sample

This research is a quantitative study using secondary data sourced from annual reports and sustainability reports. The object of this research is companies listed in the liquid 45 index (LQ45) on the Indonesia Stock Exchange in 2022-2024. The sampling method used was purposive sampling, which resulted in a sample of 39 companies and a total of 117 firm-year observations

Dependent variable: Firm value is measured using the Tobin's Q ratio. This ratio was chosen because it is considered capable of capturing the value of intangible assets and management efficiency more comprehensively. This proxy integrates the market value of equity and corporate liabilities. The Tobin's Q formula divides the sum of Market Value Equity and total liabilities by the company's total assets.

Independent variable: First, ESG Disclosure, measured using content analysis based on a checklist from the Global Reporting Initiative (GRI) standard with a binary scoring system (1 if disclosed, 0 if not). The disclosure index is calculated from the proportion of disclosed items. Second, Political Connection is measured using the ratio of the number of members of the board of commissioners and directors who have political connections to the total board size in the company. The criteria used to identify political connections, based on the background profiles of members of the board of directors and board of commissioners, are as follows: (1) being an active member of a political party; or (2) having previously served or currently serving as a minister or an official of equivalent Echelon I rank within a ministry/state institution or non-ministerial government agency; or (3) having previously held or currently holding a position as a military or police officer.

The data analysis method used is panel data regression analysis. The selection of the best model is done through a series of tests, including the Chow Test, Hausman Test, and Lagrange Multiplier Test.

RESULTS AND DISCUSSION

Descriptive Statistics and Model Selection

Picture 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ESG	117	.28866	1.00000	.7384792	.17388580
POLCON	117	.00000	.55556	.2137424	.12617500
TOBIN	117	.43556	10.57019	1.7264819	1.58729335
Valid N (listwise)	117				

Based on Figure 1, the firm value variable, proxied by Tobin's Q, shows an average value of 1.72648. This indicates that, overall, companies in the LQ45 index have an average market value 72.65% higher than the book value of their assets. The ESG disclosure variable, proxied by the ESG Score based on the GRI disclosure standard, has an average value of 0.73848. This shows that LQ45 issuers have, on average, disclosed around 73.85% of all the required sustainability disclosure indicators. The political connection variable, proxied by the proportion of board of commissioners and board of directors members with political connections, has an average value of 0.21374. This indicates that, on average, around 21.37% of the total board members in a company are politically connected.

Panel Data Regression Analysis

Picture 2. Result of the Chow Test

Source	Type III Sum of Squares	df	Mean Square	F	Sig.
Corrected Model	242.612[a]	40	6.065	9.284	<,001
Intercept	1.383	1	1.383	2.117	.150
ESG	1.089	1	1.089	1.667	.201
POLCON	.486	1	.486	.743	.391
ID_Perusahaan	233.907	38	6.155	9.422	<,001
Error	49.650	76	.653		
Total	641.009	117			
Corrected Total	292.262	116			

a. R Squared = .830 (Adjusted R Squared = .741)

The results show that the significance value is smaller than the 0.05 significance level, so H0 is rejected and H1 is accepted. It can therefore be concluded in this study that the Fixed Effect Model approach is more appropriate to use than the Common Effect Model. The selection of FEM requires further testing using the Hausman test to determine the more appropriate model between the Fixed Effect Model (FEM) and the Random Effect Model (REM).

Picture 3. Result of the Hausman Test

Source	Numerator df	Denominator df	F	Sig.
Intercept	1	36.003	4.150	.049
ESG	1	76.002	1.667	.201
POLCON	1	76.002	.743	.391
ESG_mean	1	55.360	.759	.387
POLCON_mean_1	1	107.281	.063	.802

a. Dependent Variable: TOBIN.

Based on the results of the Hausman test in Picture 3, the significance value obtained for the ESG mean variable (ESG_mean) is 0.387, and for the POLCON mean variable (POLCON_mean_1) is 0.802. Both significance values are greater than the 0.05 significance level, so H0 is accepted. It can therefore be concluded that the random effect model is the most appropriate model.

The Lagrange Multiplier test was conducted to determine the most appropriate model between the Common Effect Model (CEM) and the Random Effect Model (REM). This test is carried out by examining the significance of the covariance parameter for the random effect.

Picture 4. Result of Lagrange Multiplier Tes

Parameter		Estimate	Std. Error	Wald Z	Sig.	95% Confidence Interval	
						Lower Bound	Upper Bound
Residual		.653	.106	6.164	<,001	.475	.898
Intercept [subject = ID_Perusahaan]	Variance	1.929	.507	3.803	<,001	1.152	3.230

a. Dependent Variable: TOBIN.

Based on the results of the Lagrange Multiplier test in Picture 4, the Wald Z value for the intercept variance across companies is 3.803, with a significance value of < 0.001. Since this significance value is smaller than 0.05, it can be concluded that there is a significant individual effect, meaning the random effect model is the most appropriate model to use for estimating the effect of the ESG disclosure and political connection variables on firm value.

Hypothesis Testing

Picture 2. Coefficient of Determination

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.173[a]	.030	.013	1.57713192	2.133

a. Predictors: (Constant), POLCON, ESG

b. Dependent Variable: TOBIN

The results of the simultaneous significance test (F-Test) showed an Adjusted R Square value of 0.013 (1.3%) with an F-count value of 1.750 (p = 0.178). This indicates that the ESG disclosure and political connection variables are able to explain 1.3% of the variation in firm value. Meanwhile, the remaining 98.70% is explained by other variables outside the regression model used in this study. Because the significance level is > 0.05, ESG disclosure and political connections together do not have a significant effect on firm value.

Picture 3. Result of Partial Significance Test

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	2.211	.675		3.278	.001		
	ESG	-.029	.843	-.003	-.034	.973	.998	1.003
	POLCON	-2.169	1.162	-.172	-1.866	.065	.998	1.003

a. Dependent Variable: TOBIN

Based on the partial significance test, ESG disclosure does not show a significant effect on Tobin's Q. Theoretically, this finding indicates the presence of a barrier in the signaling theory mechanism within the Indonesian capital market. Although companies attempt to send positive signals through sustainability reports in order to reduce information asymmetry, the

market does not appear to have captured such signals as relevant information for increasing firm value. This indicates that investors in Indonesia, particularly in LQ45 index issuers, still tend to base their investment decisions on short-term fundamental financial performance indicators rather than long-term non-financial performance. This result is consistent with the argument put forward by Fadhali and Purwanto (2024), who state that markets in emerging economies such as Indonesia have not yet fully responded positively to sustainability signals. This low significance may be attributable to investors' perception that the costs of ESG integration and reporting represent additional costs that could reduce operational efficiency and future dividend potential. In addition, the insignificant effect of ESG on firm value can also be explained through legitimacy theory. It cannot be denied that the motive behind ESG disclosure among companies in the LQ45 index may be limited to fulfilling mandatory regulatory compliance in order to maintain social legitimacy and the social contract with the community and government, rather than serving as a core strategy for enhancing market competitiveness. As found in the study by Rahmah et al. (2024), ESG disclosure in Indonesia is sometimes even met with a negative market response if it is not accompanied by strong competitive advantage. This is because the market remains highly sensitive to the integration costs incurred by companies.

The political connection variable also has no significant effect on firm value, with a negative coefficient direction. Theoretically, this finding offers a different perspective on the application of the resource-based view in the Indonesian capital market. Although political connections are viewed as an intangible resource capable of providing exclusive access (Barney, 1991), the capital market appears to place greater emphasis on negative impacts, such as the agency costs arising from such relationships. Investors in LQ45 index issuers tend to perceive political connections as a signal of bureaucratic risk, inefficiency, and the potential for rent-seeking practices that could harm minority shareholders. This finding contrasts with the results of Hardiningsih et al. (2024) in Singapore, as well as Momon et al. (2020) and Joseline et al. (2021) in Indonesia, who found that political connections have a positive impact on firm value. This difference is most likely attributable to differences in sample characteristics and observation period. Issuers within the LQ45 index are companies with a very high level of visibility and public scrutiny. Under such scrutiny, the presence of political figures on the board of commissioners or board of directors may raise investor concerns about potential conflicts of interest or the use of company resources for particular political agendas rather than profit maximization. Sejalan dengan argumen ini, Haryati et al. (2021) dalam studinya pada sektor manufaktur menemukan bahwa koneksi politik tidak memberikan kontribusi terhadap peningkatan nilai perusahaan. Temuan tersebut mengindikasikan bahwa investor lebih mengapresiasi kinerja fundamental dan tata kelola profesional dibandingkan kedekatan politik. Pengaruh negatif yang ditemukan dalam penelitian ini memperkuat argumen bahwa pada emiten yang sudah likuid dan mapan seperti LQ45, koneksi politik justru dipandang sebagai beban birokrasi yang meningkatkan risiko ketidakpastian bagi pemegang saham.

These results thus indicate that, in Indonesia, particularly during the 2022–2024 period, signals of political connection are met with a negative market response. This reflects growing investor maturity, with investors placing greater value on managerial professionalism and governance transparency. Political proximity is no longer viewed as a strategic patron or form of protection, but rather as a factor that can undermine a company's credibility in achieving sustainable competitive advantage.

CONCLUSION AND RECOMMENDATIONS

Conclusion

This study concludes that neither ESG disclosure nor political connections significantly affect the firm value of LQ45 issuers on the Indonesia Stock Exchange for the 2022-2024

period. Even though the level of ESG disclosure is quite high, the market response has not been optimal in converting these non-financial signals into valuation premiums.

Limitation

This study uses the ESG disclosure and political connection variables, which together explain only 1.3% of the variation in firm value, while the remaining 98.7% is not accounted for by the independent variables examined in this study. This study focuses solely on companies listed in the LQ45 index. The characteristics of LQ45 companies, being large and highly liquid, may result in a market response that differs from that of companies in other indices or specific sectors on the Indonesia Stock Exchange.

Recommendation

The recommendation for company management is to continue improving the integration of sustainability initiatives into the core business strategy so that the benefits are clearly visualized in the company's fundamentals. Regarding political connections, companies must manage board transparency to prevent triggering concerns related to agency costs. For investors, it is recommended to be more analytical in distinguishing substantial ESG disclosures from mere regulatory fulfillment (greenwashing).

Author Contribution

All authors played a meaningful role in the completion of this study, contributing across multiple stages of the research process — from conceiving the study and building its theoretical foundation, to collecting and analyzing the data, interpreting the findings, drafting the manuscript, and revising it based on scholarly feedback. All authors have reviewed the final manuscript and give their approval for it to be published

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