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Does the Relationship between Financial Performance and Corporate Sustainability Get Affected by Agency Costs?

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Abstract: This study examines the role of agency costs in moderating the sustainability performance of companies listed on the Indonesia Stock Exchange (IDX) in relation to their financial performance. Reporting combines financial and non-financial information to improve corporate transparency and accountability, especially in companies that adhere to environmental, social, and governance (ESG) principles. Based on stakeholder theory and legitimacy theory, this study employs a quantitative research design using panel data from companies listed on the Indonesia Stock Exchange (IDX) with ESG values from 2019 to 2023. The research findings reveal that ESG does not have a significant direct impact on ROA, indicating that corporate sustainability does not automatically impact financial performance without adequate internal conditions. However, when control variables are accounted for, the impact of ESG on ROA becomes significant. FCF has a positive impact on ROA but does not moderate the relationship between ESG and ROA. This suggests that excess cash does not automatically enhance the effectiveness of ESG. Conversely, ER is proven to be a significant moderator that strengthens the influence of ESG on ROA. This means that efficient companies are better able to translate ESG into competitive advantages that impact financial performance. This study contributes to the literature by offering a new perspective on how agency costs moderate the relationship between corporate sustainability and financial performance.

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INTRODUCTION

Public awareness of sustainability aspects in the business world continues to increase, which encourages companies to pay more attention to environmental, social and corporate governance (ESG) issues (Gao et al., 2022; Rau & Yu, 2024; Widyawati, 2020). Corporate Sustainability Performance (CSP) has become one of the important indicators in assessing a company's commitment to environmental, social, and corporate governance (ESG) sustainability. Along with increasing attention to sustainability, pressure from regulators, investors and consumers related to ESG reporting transparency is also faced by companies (Farooq, 2023; Yu, 2025). In recent years, this trend has been further reinforced by the emergence of global policies that encourage disclosure of information related to sustainability practices (Santhi et al., 2024).

Corporate sustainability performance (CSP) is not only a measure of a company's commitment to sustainability but is also often linked to financial performance (FP). Various studies in the past have examined the relationship between corporate sustainability performance (CSP) and financial performance (FP), the results obtained still show inconsistencies. Some of the research studies show that companies with better sustainability performance tend to experience an improvement in financial performance because they get a better reputation, higher customer loyalty, and attract more investors (Gao et al., 2022; Netto et al., 2020). On the other hand, research conducted by (Jha & Rangarajan, 2020; Santhi et al., 2024) shows the results that excessive implementation of sustainability without a proper strategy can burden corporate finances and reduce profitability. The inconsistency of research results indicates that there are other factors that can moderate the relationship between corporate sustainability performance (CSP) and financial performance, one of which is agency costs (Kalash, 2023b) .

A recent phenomenon that has attracted attention in sustainability discussions is the rise of greenwashing practices. Like individuals, companies also face challenges in building their image. Greenwashing emerges as a result of companies' concern for their image, especially when they seek to present themselves as socially concerned entities and claim to have implemented ESG principles, when in fact they are not fulfilling their supposed responsibilities or failing to realize their commitments to ESG (Rau & Yu, 2024) . This practice can worsen the relationship between corporate sustainability performance (CSP) and financial performance (FP) as it can lower stakeholder trust and increase reputational risk and regulatory sanctions (Santos et al., 2024) . In this context, agency costs are an important factor that can strengthen or weaken the relationship between corporate sustainability performance (CSP) and financial performance (FP). Agency costs reflect the conflict of interest between management and shareholders, conflicts occur due to a mismatch of interests between company management that focuses on short-term image and shareholders who expect long-term value (Almulhim et al., 2024) . In addition, agency costs can arise when it is difficult for shareholders to monitor whether the sustainability strategy implemented actually provides optimal financial benefits (Li et al., 2021) . In some cases, high agency costs can weaken the positive impact of corporate sustainability performance (CSP) on financial performance by adding inefficiencies in corporate management (Almulhim & Aljughaiman, 2023; Rahi et al., 2024) .

This research provides a novel contribution by examining whether agency costs moderate the relationship between financial performance and corporate sustainability in the context of Indonesian listed companies. Unlike previous studies that have predominantly focused on the direct linkage between financial performance and sustainability outcomes, this study integrates agency theory to capture the influence of managerial opportunism and shareholder–management conflicts on corporate sustainability practices. The Indonesian setting offers a distinctive institutional environment characterized by concentrated ownership, family-controlled firms, and evolving sustainability regulations, which may produce dynamics different from those observed in developed markets. By highlighting the role of agency costs in shaping the sustainability, performance nexus within an emerging market, this research generates fresh empirical evidence that can inform governance reforms, strengthen sustainability strategies, and enrich the theoretical understanding of how internal governance mechanisms interact with corporate financial outcomes.

In addition, this study is expected to strengthen the understanding of decision makers in the company about the importance of implementing the actual corporate sustainability performance (CSP) (Jha & Rangarajan, 2020; Santhi et al., 2024). Companies can take steps to reduce agency conflicts or interests between management and shareholders (Rau & Yu, 2024) by understanding the impact of agency costs on the relationship between corporate sustainability performance (CSP) and financial performance (FP).

In addition, the results of this study can guide companies in recognizing sustainability practices that are truly effective and capable of improving financial performance, so that companies can strengthen public trust and reputation. Thus, this study supports companies in designing sustainability strategies that have a positive impact, are sustainable, and minimize reputational risks.

LITERATURE REVIEW AND HYPOTHESES

Stakeholder Theory proposed by (Freeman & McVea, 2005) states that companies are not only responsible to shareholders, but also to all stakeholders affected by the company's business activities,

including employees, consumers, investors, government, regulators, and the general public. This approach emphasizes that the long-term success of the company is highly dependent on its ability to maintain harmonious relationships with all these interest groups (Mahajan et al., 2023).

In the context of corporate sustainability performance, stakeholder theory provides a theoretical basis that companies that pay attention to environmental, social and governance (ESG) aspects will be better able to meet the expectations and demands of stakeholders (Yoo, 2025). The company's alignment with sustainability has the potential to increase public trust, consumer loyalty, investor preference, and government support. These conditions, in turn, are believed to be able to improve reputation, business stability, and corporate financial performance (Alam & Tariq, 2023; Kalash, 2023b).

However, the implementation of sustainability strategies does not necessarily have a positive impact on financial performance. (Jha & Rangarajan, 2020) shows that companies that carry out excessive sustainability initiatives without careful strategic planning actually face additional financial burdens. This reflects that stakeholder management through ESG needs to be done efficiently and integrated with the company's business objectives (Cardillo & Basso, 2025). Stakeholder Theory in this study is used as a basis to explain the relationship between corporate sustainability performance (CSP) and financial performance (FP). The mechanism is as follows when companies respond to stakeholder expectations through sustainability practices, there will be an increase in social trust and legitimacy, which strengthens competitive advantage and drives financial achievement (Sulemana et al., 2025). However, this relationship is not linear or absolute. In practice, the relationship between corporate sustainability performance (CSP) and financial performance (FP) can be influenced by internal conditions, such as the level of efficiency and potential managerial conflicts of interest (agency costs) (Burcă et al., 2024).

It should be noted that Stakeholder Theory has limitations. It assumes that all stakeholder groups have equal influence, whereas in an emerging market context, the power of certain stakeholders (such as institutional investors or regulators) can be more dominant than others (Harjoto et al., 2022; Talan et al., 2024). In addition, not all companies have sufficient resources and governance to respond to all stakeholder expectations in a balanced manner. In contrast to Agency Theory, which focuses on the interests of shareholders and controls the behavior of managers, Stakeholder Theory emphasizes an inclusive approach to corporate decision making (Khandelwal et al., 2023). Therefore, in the framework of this study, Stakeholder Theory serves as a foundation to test the effect of corporate sustainability performance (CSP) on firm performance (FP), considering agency cost as a moderating variable that can strengthen or weaken the relationship (Almici, 2022).

Legitimacy Theory suggests that companies need to gain social legitimacy to ensure the sustainability of their operations (Suchman, 1995). In the context of corporate sustainability performance (CSP), companies that invest in sustainability tend to gain support from society and investors, thereby improving their reputation and financial stability (Rahi et al., 2024). However, challenges begin to arise when companies engage in greenwashing, which is the practice of creating exaggerated impressions of sustainability without concrete actions, which can undermine public trust and reduce the long-term value of the company (Santos et al., 2024).

Research conducted by Netto et al. (2020) shows that greenwashing can have a negative impact on corporate reputation, which in turn affects financial performance (FP). Therefore, transparency in environmental, social, and corporate governance (ESG) reporting is an important factor to ensure that commitments to sustainability are actually realized in business practices.

Corporate Sustainability Performance (CSP) and Financial Performance (FP)

Research related to corporate sustainability performance (CSP) and financial performance (FP) has been studied by several previous researchers and the results obtained also vary. A company's responsibility to the environment leads to good corporate financial performance (Santhi et al., 2024). The results of previous research (Poursoleyman et al., 2022) found that social and environmental performance indirectly increases CFP by reducing underinvestment problems. The companies that have superior performance related to the environment tend to get a positive reputation and support from stakeholders. Increased customer loyalty and higher product demand, fueled by environmental awareness, contribute to increased

revenue and market share (Alam & Tariq, 2023) . The research also reveals that the positive impact of corporate sustainability performance (CSP) on Return on Assets (ROA) is only significant for firms that are more likely to face debt agency costs, such as firms with R&D expenditures, which is in line with previous research findings (Guo et al., 2020) . Companies by increasing their involvement in sustainability initiatives can improve financial performance, supporting the assumption of stakeholder theory, which states that companies that establish solid relationships with stakeholders and meet their expectations can gain a competitive advantage and drive growth and sales, thereby improving overall performance (Kalash, 2023b) . Although most researchers find a positive relationship between CSP and FP, there are still some researchers who find the opposite, Research according to (Jha & Rangarajan, 2020) Companies that show better sustainability performance do not always have better financial performance compared to companies that have lower sustainability performance. If there is an effect, it is more related to the environmental dimension, which can actually reduce financial performance (Jha & Rangarajan, 2020) . From the results of previous studies that get different results, therefore the first hypothesis is explained as follows.

H1: Corporate Sustainability Performance has a significant positive effect on Financial Performance positively

Corporate Sustainability Performance, Financial Performance, and Agency Costs

Corporate sustainability performance (CSP) and financial performance can be strengthened or weakened by agency costs. Agency costs arise when both parties in a relationship strive to achieve their own desires (Behbahaninia, 2024) . Managers often choose to use available surplus cash to invest in short-term sustainability projects. This action can have a negative impact on firm performance, as they have to bear the costs arising from these projects without obtaining long-term benefits (Franco et al., 2020) . Research by (Franco et al., 2020) shows a U-shaped relationship between corporate social responsibility (CSR) and financial performance (FP). This suggests that spending on CSR will not provide significant benefits unless the company is able to build solid relationships with its stakeholders. Some previous researchers found that good corporate sustainability performance (CSP) can lower agency costs by increasing transparency and accountability, which encourages managers to act in line with shareholders' interests. For example, research conducted by Almulhim & Aljughaiman (2023) indicates that effective corporate sustainability performance (CSP) can improve the financial performance (FP) of companies by reducing conflicts of interest between managers and shareholders. Research conducted by (Li et al., 2021) shows that reducing the number of board members can help lower agency costs and increase the company's potential for sustainable growth. Efficient implementation of sustainability practices can contribute to improved financial performance of a company. However, this relationship is affected by a number of factors, such as corporate governance and agency costs (Rahi et al., 2024) . Research from (Rahi et al., 2024) shows that good governance can strengthen sustainability performance, which in turn has a positive impact on financial performance. Based on the arguments of previous researchers, the second hypothesis is explained as follows.

H2: Agency cost can moderate the relationship between corporate sustainability performance and financial performance.

METHODS

Population and Sample

This study uses a sample population of secondary data obtained from annual reports, sustainability reports, and financial reports of companies listed on the Indonesia Stock Exchange (IDX). The initial population includes all companies that consistently report sustainability performance (ESG score) during the 2019-2023 period. After searching the IDX website in the listed company section, especially the ESG Score, a final sample of 88 companies was obtained.

It should be noted that some of the data in this study is unstructured data, as not all companies consistently published annual reports or sustainability reports during the period 2019 to 2023. In some cases, sustainability data was only available in narrative form in annual reports or obtained separately through external sources such as company websites. Therefore, the researcher conducted a content analysis process to convert the narrative information into structured data in the form of ESG scores. This approach is in line with the method used in unstructured data-based ESG research (Netto et al., 2020).

Variables

Table 1 show the description of all the variables in account and their measurement.

Table 1 . Variable Measurement

Variable	Mnemonic	Measurement
Dependent variable		
Financial Performance	ROA	ROA = Net Income after tax/ Total assets (Itan et al., 2024)
Independent variable		
Corporate Sustainability Performance	ESG	Corporate sustainability performance examined with using 126 components GRI standards (Butar-Butar et al., 2025; Butar-Butar & Itan, 2025; Jha & Rangarajan, 2020)
Moderating variable		
Agency Cost	FCF	FCF = (Operating cash flow – capital expenditures)/ Total assets (Kalash, 2023b)
	ER	ER = Sales/ Total assets (Kalash, 2023b)
Control variable		
Firm Size	FSIZE	Natural logarithm of total assets (Butar-butur et al., 2024)

Data Analysis Techniques

This study used linear regression analysis as its main technique. During the process, a number of tests were conducted to ensure that the assumptions underlying the regression analysis were met, making the results valid and reliable. The stages in this analysis include descriptive statistics, and inferential statistical tests such as F-test, T-test, and coefficient of determination analysis. To test hypothesis 1 and hypothesis 2 which predict that CSP can influence FP and Agency Cost can moderate CSP on FP, we estimate the following set of equations using Panel OLS Regression:

Model 1 : $ROA = \beta_0 + \beta_1 ESG + e$

Model 2 : $ROA = \beta_0 + \beta_1 ESG + \beta_2 AGENCY (FCF) + \beta_3 AGENCY (ER) + e$

Model 3 : $ROA = \beta_0 + \beta_1 ESG + \beta_2 ESGXAG1 + \beta_3 ESGXAG2 + AGENCY (FCF) + \beta_3 AGENCY (ER) + e$

RESULTS AND DISCUSSION

The statistical test results of the variables used in this study can be seen in Table 2 below. From the test results of Table 2. shows that the average Return on Assets (ROA) is 0.063, with a standard deviation of 0.120 and a minimum value of -1.671, indicating a variation in financial performance between companies, indicating a significant diversity of financial performance among sample companies, while ESG as a proxy for Corporate Sustainability Performance (CSP) has an average of 0.339 and a standard deviation of 0.298, indicating a difference in the level of sustainability disclosure between companies, which is in line with the findings of (Widyawati, 2020) that the level of ESG adoption in emerging markets still varies.

Table 2. Test Statistics

	N	Mean	Standard Deviation	Minimum	Maximum
ROA	435	0.063	0.120	-1.671	0.664
ESG	435	0.339	0.298	0.000	1.000
AGENCYFCF	435	0.065	0.159	-0.976	0.813
AGENCYER	435	0.618	0.656	-0.271	3.822
FSIZE	435	29.233	7.042	0.000	35.315

Agency costs measured through Free Cash Flow (FCF) and Efficiency Ratio (ER) show an average value of 0.065 and 0.618 respectively. The standard deviations of both variables are quite high (0.159 for FCF, 0.656 for ER), indicating significant differences in the ability of companies to manage free cash and operational efficiency. This variation is important, as it may affect how effectively firms implement ESG strategies (Almulhim & Aljughaiman, 2023)

Table 3. Correlation Test

	ROA	ESG	AGENCYFCF	AGENCYER	FSIZE
ROA	1.000				
ESG	0.093* (0.052)	1.000			
AGENCY FCF	0.357*** (0.000)	-0.050 (0.303)	1.000		
AGENCY ER	0.306*** (0.000)	-0.044 (0.363)	0.312*** (0.000)	1.000	
FSIZE	0.075 (0.116)	0.241*** (0.000)	0.081* (0.091)	0.145*** (0.002)	1.000

p-values in parentheses

*p < 0.1, **p < 0.05, ***p < 0.01

The correlation test results in Table 3. show a significant positive relationship between ESG and ROA ($r = 0.093$; $p < 0.1$), supporting the study (Alam & Tariq, 2023) that ESG implementation can contribute to financial performance. The correlation between ROA and agency cost variables is also significant and quite strong: FCF ($r = 0.357$; $p < 0.01$) and ER ($r = 0.306$; $p < 0.01$), indicating that a company's internal conditions play an important role in financial performance, supporting the literature stating that ESG's success in improving a company's bottom line depends largely on how the company manages its day-to-day business activities. It is not enough for ESG to be reported on paper, but it needs to be executed in an efficient and planned manner in order to truly bring financial benefits (Sahut & Pasquini-Descomps, 2015).

Table 4. Moderation Test Result

	(1) ROA	(2) ROA	(3) ROA
ESG	0.019 (0.99)	0.039** (1.97)	0.006 (0.22)
FSIZE	0.001** (2.30)	-0.000 (-0.23)	0.000 (0.16)
AGENCYFCF		0.196*** (5.78)	0.194*** (3.36)
AGENCYER		0.038* (1.97)	0.027 (0.61)

		(1.95)	(1.39)
ESGXAG1			-0.014
			(-0.12)
ESGXAG2			0.053**
			(2.04)
_cons	0.082***	0.037*	0.036*
	(4.56)	(1.83)	(1.74)
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
r2	0.129	0.238	0.242
r2_a	0.095	0.205	0.205
N	435	435	435

t statistics in parentheses

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

The test results of Table 4. in Model 1 show that the effect of ESG on ROA is positive but not statistically significant ($\beta = 0.019$; $t = 0.99$; $p > 0.1$). This finding suggests that ESG implementation does not automatically result in better financial performance, consistent with research (Jha & Rangarajan, 2020) which found that the impact of ESG on financial performance is contextual and depends on how ESG is integrated in business strategy. This result is also in line with the findings of Rahi et al., 2024 & Santhi et al., 2024 . who cautioned that ESG practices in emerging markets are often still symbolic management or greenwashing, thus not yet providing significant financial benefits. ESG can indeed enhance reputation (Netto et al., 2020) , but without efficient internal governance and management, ESG can become a cost burden (Guo et al., 2020) . In other words, although Stakeholder Theory (Freeman & McVea, 2005) states that companies that care about stakeholder interests will gain social support and good reputation, the results of this study show that such support does not always immediately materialize in the form of profitability, especially when ESG is only a formality.

When the moderating variable is included in Model 2 of Table 4, the coefficient of ESG rises to be significant ($\beta = 0.039$; $t = 1.97$; $p < 0.05$). This indicates that the effect of ESG on ROA only appears when the internal conditions of the company are taken into account, supporting the Resource-Based View theory (Barney, 2015) that competitive advantages, including ESG, can only be realized if the company has sufficient internal resources. Free Cash Flow (FCF) has a significant positive effect on ROA ($\beta = 0.196$; $t = 5.78$; $p < 0.01$). This finding supports the literature stating that companies with free cash are more flexible in investing, including in sustainability projects (Almulhim & Aljughaiman, 2023) . However, the literature also warns that FCF can be a double-edged knife. Efficiency Ratio (ER) also shows a positive influence on ROA ($\beta = 0.038$; $t = 1.95$; $p < 0.1$). This finding is consistent with research (Rahi et al., 2024) which shows that companies with high levels of efficiency are better able to integrate ESG into business operations, thereby improving financial performance.

In Model 3 Table 4. testing the interaction effect of ESG with moderating variables, on the interaction of ESG x FCF (ESGXAG1) the interaction coefficient is not significant ($\beta = -0.014$; $t = -0.12$; $p > 0.1$). This result indicates that excess free cash does not automatically strengthen the effect of ESG on financial performance. This is consistent with the findings of Kalash (2023b) which emphasizes that high FCF without adequate governance is potentially a source of agency problems, rather than a force to support ESG. This result is also in line with Agency theory, where managers may use excess cash for symbolic projects in their personal interest, not shareholders' interest. As for the ESG x ER interaction (ESGXAG2), the interaction coefficient is positive and significant ($\beta = 0.053$; $t = 2.04$; $p < 0.05$). This finding suggests that operational efficiency is key for ESG to have a positive impact on ROA. This result supports stakeholder theory and agency theory at the same time. Stakeholder Theory states that companies that are able to manage ESG efficiently will gain the trust of stakeholders (Freeman & McVea, 2005). Meanwhile, Agency Theory explains that efficient companies will face less agency cost, so that ESG funds are actually used to create value (M. Jensen & Meckling, 1976). Thus, efficiency (ER) serves as a significant moderator, strengthening the effect of ESG on ROA. This also supports the results of research (Boskin, 2012) , which

shows that ESG provides financial value only if it is implemented strategically and efficiently. The Adjusted R² value increases from 9.5% in Model 1 to 20.5% in Models 2 and 3, indicating that adding moderating variables significantly improves the model's ability to explain variations in ROA.

H1 states that Corporate Sustainability Performance (ESG) has a positive effect on financial performance (ROA). Model 1 in Table 4. tests the direct effect of ESG on ROA and shows ESG is insignificant on ROA. Therefore, H1 is not proven. However, the direction of the relationship remains positive, suggesting an initial indication that ESG may contribute to ROA. This finding is not entirely consistent with stakeholder theory (Freeman & David, 1983), which states that companies that pay attention to the interests of stakeholders will gain social legitimacy and economic support. Research Jha & Rangarajan (2020) and Kalash (2023b), which found that ESG does not always have a direct impact on financial performance if it is only carried out as a formality (greenwashing). According to Stakeholder Theory (Freeman & David, 1983) and Legitimacy Theory (Suchman, 1995), ESG only has a positive impact if it is actually implemented in real terms so as to gain stakeholder trust and public legitimacy. This insignificance is also in line with Kalash (2023a) and Kalash (2023b) which shows that ESG without strong governance can be a form of greenwashing and is not effective in increasing profitability. As for H2, it states that agency costs, measured through FCF and ER, moderate the relationship between ESG and ROA. From the test results in model 2 Table 4. shows that FCF and ER have a significant positive effect on ROA. This indicates that the effect of ESG on ROA becomes stronger when the internal efficiency of the company is taken into account. This finding is consistent with the Resource-Based View (RBV) (Barney, 2015), which states that free cash flow is a strategic resource that companies can use to invest in productive activities. However, Agency Theory (Jensen & Meckling, 1976), also warns that free cash flow can increase agency costs if misused by managers. It is also consistent with Stakeholder Theory, as efficient companies are able to optimally manage resources, including ESG implementation, thus improving financial performance (Boskin, 2012; Kalash, 2023b, 2023a). In Table 4. the results of Model 3 show that the ESG × FCF interaction is not significant. This finding supports Agency Theory, where free cash funds can be a source of conflict of interest if not directed to productive activities (M. Jensen & Meckling, 1976). Although FCF increases ROA directly, excess cash does not automatically make ESG have a greater impact, especially when ESG is only an image tool (Kalash, 2023b, 2023a). While the ESG × ER interaction is significantly positive, this finding suggests that operational efficiency strengthens the relationship between ESG and ROA. This is in line with Stakeholder Theory and Legitimacy Theory, which state that public legitimacy is achieved if ESG is truly implemented effectively. In addition, it supports RBV, as efficiency is an internal capability that helps firms translate ESG into competitive advantage (Boskin, 2012; Rahi et al., 2024). So, the results show that agency cost variables have different roles as moderators. Free Cash Flow (FCF) is not proven to moderate the relationship between ESG and financial performance, so it does not strengthen or weaken the influence of ESG. In contrast, Efficiency Ratio (ER) is proven to strengthen the relationship of ESG to financial performance, indicating that more efficient companies are better able to translate ESG into better financial performance. Therefore, H2 is partially supported. This finding is consistent with agency theory M. Jensen & Meckling (1976) which explains that internal control structures such as asset efficiency can reduce agency costs and strengthen the effectiveness of ESG investments. Kalash (2023b, 2023a) also suggests that operational efficiency is an important prerequisite for ESG to have a positive financial impact.

This finding suggests that the effect of ESG on financial performance is not independent, but rather influenced by internal management efficiency. FCF as a form of free funds does not show a moderating role, perhaps because not all companies use FCF for strategic purposes that support ESG. This result supports the view that high cash flow without adequate governance can increase the risk of agency conflict. On the other hand, asset efficiency (ER) proved to be able to strengthen the effect of ESG on ROA. Operational efficiency reflects the productive and optimal use of resources, thus ensuring that ESG investments have a real financial impact. The type of moderation found is quasi moderation, where only one of the two interactions is significant. This means that agency costs (specifically ER) not only affect ROA directly, but also moderate the effect of ESG on ROA.

This study makes an important contribution to the literature. In contrast to Jha & Rangarajan (2020), which found ESG to be insignificant in developing countries, this study proves ESG can have a significant impact when companies have high efficiency. This suggests ER is an important moderating factor, which has not been widely explored in the Indonesian context. This study also strengthens the literature that ESG is not just a reporting formality, but needs to be integrated into the internal management of the company. However, several studies Kalash (2023b) suggest the Environmental, Social, and Governance dimensions may have different influences on ROA. Future research needs to examine each dimension separately to find out which dimension best moderates the effect of ESG on financial performance. As a robustness test, the model is re-estimated using robust standard errors. The results still show significance in ESG and ESG×ER interaction, which strengthens the validity of these findings.

Practically speaking, financial managers and policy makers in companies need to realize that it is not enough for ESG strategies to be implemented symbolically, but they must be linked to internal efficiency. This implication is in line with Kalash (2023b, 2023a), which suggests that ESG is effective when integrated in control and governance systems. Regulators such as OJK may also consider these results to strengthen sustainability audit policies to not only encourage ESG reporting, but also evaluate its effectiveness. Particularly in the Indonesian context, where ESG regulations from OJK and IDX are strengthening, these results support the importance of ESG integration in corporate strategy. This is important for maintaining reputation, long-term sustainability and investor confidence.

CONCLUSION

This study aims to analyze the effect of Corporate Sustainability Performance (CSP) or ESG on financial performance (ROA), by considering the role of agency costs as measured by Free Cash Flow (FCF) and Efficiency Ratio (ER) as moderating variables. The research was conducted on public companies in Indonesia. The results showed that ESG does not have a significant direct influence on ROA. This indicates that corporate sustainability does not automatically impact financial performance if it is not supported by adequate internal conditions. This finding is in line with the literature which states that ESG is often only symbolic (greenwashing) without real implementation that has a financial impact (Jha & Rangarajan, 2020). However, when control variables are taken into account, the effect of ESG on ROA becomes significant. FCF has a positive effect on ROA, but does not moderate the relationship between ESG and ROA. This suggests that excess cash does not automatically drive ESG to be more effective, supporting Agency theory which states that free cash funds are at risk of being misused for unproductive projects (M. C. Jensen, 2009). In contrast, ER proves to be a significant moderator that strengthens the effect of ESG on ROA. This means that efficient companies are better able to translate ESG into competitive advantages that have an impact on financial performance. This finding supports Stakeholder Theory and Legitimacy Theory. This study contributes to the literature by showing that ESG has no direct influence on financial performance unless supported by the firm's internal efficiency. This study differs from previous studies (Kirani & Wijayanti, 2023; Puti Azzahra Vania Eriany & Luluk Widyawati, 2024) that did not test the moderating role of efficiency, thus adding to the understanding of the internal factors that influence the success of ESG, particularly in emerging markets such as Indonesia. Although the results show a relationship between ESG and ROA, this study cannot infer a causal relationship as it uses a panel OLS design. Future research is recommended to use a dynamic model or instrument variable approach.

The results of this study provide important implications for investors and policymakers that ESG success cannot be used as a guarantee of improved corporate financial performance without the support of adequate internal capabilities, especially operational efficiency. For investors, this is a warning to not only rely on aggregate ESG scores in making investment decisions, but also to evaluate the extent to which companies actually implement ESG in real terms, not just a formality report or greenwashing. Meanwhile, for policymakers such as OJK, IDX, and the government, these results point to the need for more comprehensive regulations that not only require ESG reporting, but also include performance-based audits to ensure ESG is effectively implemented. The government can also consider incentive policies, such as tax deductions for companies that are proven to be able to run ESG efficiently, as well as developing reporting

standards that separate each Environmental, Social, and Governance dimension for more targeted and accountable supervision.

For company management, this study emphasizes that ESG is not enough to be an administrative obligation or image tool, but must be truly integrated into business strategies that support operational efficiency. Managers need to be more selective in allocating Free Cash Flow (FCF) to be directed to ESG projects that have real added value, thus avoiding the risk of agency costs that only burden the company without providing financial benefits. Internal efficiency proves to be a key factor that allows ESG to make a positive contribution to financial performance, so companies need to establish a strict monitoring and evaluation system for ESG implementation. In addition, management should also be committed to data-based and verifiable ESG reporting transparency, so that investor and stakeholder trust can be maintained and the company's legitimacy is stronger in the eyes of the public.

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