# Environmental, social, and governance (ESG) performance and firm perfomance: Does sharia compliance matters?

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***ABSTRACT***

*This study aims to examine the influence of Environmental, Social, and Governance (ESG) Performance on Firm Performance and the moderating role of Shariah Compliance in companies in Indonesia. The study uses a quantitative approach with an explanatory research design and utilizes panel data of 305 company observations during the 2019–2024 period. The analysis was conducted using a regression model with Return on Equity (ROE) and Tobin's Q as proxies for Firm Performance, and Shariah Compliance as a moderating variable. The results show that ESG Performance has a positive and significant effect on ROE, but does not significantly affect Tobin's Q. At the same time, Shariah Compliance has a direct negative effect on firm performance, but is proven to strengthen the relationship between ESG Performance and Firm Performance. These findings indicate that ESG implementation supported by compliance with sharia principles can improve company performance more optimally, both in terms of profitability and firm value. Therefore, companies need to integrate ESG practices with sharia principles as a strategy to improve long-term performance, strengthen corporate legitimacy, and increase investor confidence.*

***Keywords:*** *ESG Performance; Firm Performance; Sharia Compliance; ROE; Tobin's Q*

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## INTRODUCTION

Sustainability issues are increasingly gaining global attention, especially following the emergence of the Environmental Social Governance (ESG) concept as a benchmark for corporate sustainability performance (Gao et al., 2021). ESG describes a company's ability to effectively manage environmental, social, and governance aspects to generate long-term sustainable value (Liu et al., 2022). Various empirical studies have shown that ESG is linked to firm performance, both from an accounting perspective, such as Return on Equity (ROE), and from a market perspective, such as Tobin's Q (Aydoğmuş et al., 2022;Wut et al., 2023; Zheng & Bu, 2024; Zou, 2025).

In Indonesia, attention to ESG is increasing in line with the Financial Services Authority (OJK)'s push through the Sustainable Finance Roadmap and mandatory sustainability reporting requirements. Agustin et al., (2025) stated that this strategy encourages companies to be more transparent in disclosing sustainability practices as part of their long-term strategy. However, empirical evidence suggests that increased ESG implementation has not always been followed by consistent improvements in firm performance (Shaikh, 2021). Some companies with relatively high ESG scores do not always show improved financial performance or increased market value (Xu et al., 2022). In fact, empirical research shows that ESG disclosure can have a neutral or negative impact on company value when ESG information is not fully understood and efficiently responded to by the market (Pulino et al., 2022;Aydoğmuş et al., 2022; Angir, 2024).

This phenomenon becomes even more complex when associated with companies operating under Sharia principles. Sharia compliance companies in Indonesia must not only strive for profit but also adhere to Islamic financial regulations that emphasize fairness, transparency, and social responsibility. Conceptually, Sharia compliance is believed to strengthen the ethical and governance dimensions of a company, potentially strengthening the relationship between ESG performance and firm performance (Pujiastuti et al., 2024; Asni et al., 2024). However, empirical evidence shows that Sharia companies do not necessarily have superior ESG Performance compared to non-Sharia companies, particularly in certain sectors such as the energy sector (Awaludin et al., 2025).

On the other hand, differences in the level of Sharia compliance and the quality of ESG implementation among Sharia compliance companies persist, potentially leading to variations in the impact of ESG on firm performance. This situation reinforces the empirical evidence regarding the role of Sharia Compliance in strengthening or weakening the relationship between ESG performance and firm performance in the Indonesian capital market (Asni et al., 2024; Awaludin et al., 2025).

Previous findings also show mixed results. Several studies found that ESG has a positive effect on firm performance, while others indicate that the effect of ESG is highly dependent on the institutional context, industry sector, and market characteristics (Pulino et al., 2022;Aydoğmuş et al., 2022;Fu et al., 2024;Attia & Almoneef, 2025;Angir, 2024;Hesniati et al., 2025). This inconsistent result indicates that the relationship between ESG and firm performance is not yet fully conclusive and requires further testing.

A strand of studies have been conducted primarily on non-Sharia compliance companies or in developed countries (Barbosa et al., 2023). Research specifically examining the role of Sharia compliance as a moderating variable in the relationship between ESG performance and firm performance remains relatively limited, particularly among Sharia compliance companies in Indonesia. Yet, the growing interest in Sharia compliance sustainable investment demands more contextual and relevant empirical evidence (Pujiastuti et al., 2024; Asni et al., 2024; Zou, 2025).

Based on this phenomenon, this study aims to examine the influence of ESG performance on firm performance in Islamic companies in Indonesia and analyze the role of Sharia compliance as a moderating variable. Referring to the background description presented, the research questions can be formulated as follows: Does ESG performance influence firm performance in Islamic companies? And does Sharia compliance strengthen the relationship between ESG performance and firm performance?

Theoretical benefits include contributing to the literature on the relationship between ESG Performance, Sharia Compliance, and Firm Performance, particularly in the context of companies operating under Islamic finance principles. This research also broadens understanding of how non-financial factors (such as ESG and Sharia compliance) can affect company performance. Practically, this research serves as a reference for company management in improving performance through the implementation of good ESG practices while maintaining compliance with Sharia principles. The findings of this study are also useful for Islamic investors to consider ESG aspects and Sharia compliance in determining investment decisions.

## LITERATURE REVIEW, RESEARCH FRAMEWORK, AND HYPOTHESIS

### Stakeholder Theory

According to Freeman & McVea, (2005) stakeholder theory states that companies have obligations not only to shareholders but also to all stakeholders, such as workers, consumers, communities, governments, and the environment. In this context, the implementation of Environmental, Social, and Governance (ESG) is one way for companies to demonstrate their responsibility to all stakeholders.

Companies with good ESG practices will be more trusted by investors and the public, thereby improving reputation, reducing risk, and strengthening financial performance. Attia and Almoneef (2025) found that high ESG scores positively influence company performance in the MENAT region, indicating that socially and environmentally responsible companies tend to be more profitable. A similar finding was also conveyed by Aydoğmuş et al., (2022) who defined ESG practices as increasing the value and profitability of companies in Turkey.

Meanwhile, Fani and Prijadi (2025) emphasized that the implementation of green bonds and sustainable policies has been proven to strengthen corporate value, in line with stakeholder theory's view that concern for sustainability is a crucial strategy for creating long-term value.

### Legitimacy Theory

Legitimacy theory states that the sustainability of a company's operations depends on the extent to which its activities align with prevailing social values and norms (Suchman, 1995). When a company implements policies that align with societal expectations, such as ESG practices, it gains social legitimacy, strengthening its market position. According to Fu et al., (2024), public legitimacy built through social and environmental responsibility contributes to stable firm performance, particularly during periods of economic uncertainty. In the context of Islamic finance, Sharia compliance can strengthen this legitimacy by demonstrating that a company operates in accordance with the principles of fairness, transparency, and the prohibition of unethical practices.

The findings of Fani and Prijadi (2025) support this legitimacy theory by showing that implementing green policies, including green bonds, increases firm value because the public perceives the company as more ethical and responsible. Similarly, Pujiastuti et al. (2024) explain that the combination of Sharia compliance and ESG practices broadens a company's legitimacy in the eyes of the Muslim public and investors, thereby strengthening the positive relationship between ESG performance and firm performance.

### The Role of ESG Performance on Firm Performance

Firm Performance encompasses a business's ability to generate profits and deliver value to shareholders and the overall market. This performance demonstrates the company's effectiveness in utilizing its resources to achieve financial targets while maintaining long-term sustainability (Kramaric, 2023). In this study, company performance is measured through two main indicators: Return on Equity (ROE) and Tobin's Q. ROE evaluates the company's efficiency in generating net income based on existing equity, thus reflecting its internal profitability level and financial perfomance (Firmansyah et al., 2023). Tobin's Q, on the other hand, shows the company's market value compared to the book value of its assets, which is a measure of how the market views the company's potential for future growth and value. If the Tobin's Q value is greater than one, it indicates that the market has a positive assessment of the company, indicating an opportunity to create value for investors (Cardao-pito, 2022).

Previous studies have shown that good sustainability practices can improve company performance. Wu et al., (2022) found that ESG performance positively impacts firm performance, as measured by Tobin's Q, indicating that environmental, social, and governance responsibilities can increase market confidence. Similar findings were also presented by Naeem et al., (2022) and Agustin et al., (2024) who explained that ESG performance is positively related to profitability (ROE) and firm value (Tobin's Q). Therefore, the Firm Performance variable in this model serves as the primary benchmark for assessing the extent to which ESG implementation and Sharia compliance can positively impact a company's financial performance and market value.

ESG Performance is an integrated approach, reflecting the Company's dedication to carrying out socially responsible activities, and managed with the principles of good governance (Tjahjadi et al., 2021). The environmental aspect (environmental performance) demonstrates the company's ability to manage the impact of its operations on the environment through energy efficiency, carbon emission reduction, and sustainable waste management. Good environmental performance not only enhances the company's reputation but also reduces regulatory risks and increases operational cost efficiency, which ultimately has a positive impact on the company's financial performance and market value (Li, 2023; Ivascu et al., 2022).

Furthermore, the social aspect (social performance) reflects a company's responsibility to build harmonious relationships with employees, communities, and other stakeholders (Signori et al., 2021). Effective implementation of corporate social responsibility (CSR) programs can increase employee loyalty, strengthen brand image, and mitigate social and reputational risks (Nguyen et al., 2021). The social dimension of ESG has been shown to positively contribute to company productivity, customer satisfaction, and increased profitability and market value in the long term (Shaikh, 2021).

Furthermore, governance performance demonstrates the extent to which a company implements the principles of transparency, accountability, and honesty in its decision-making process. Good governance plays a role in reducing agency conflicts, increasing managerial efficiency, and protecting shareholder interests. Previous research has shown that governance performance plays a crucial role in converting sustainability practices into competitive advantage and increasing company value (Ivascu et al., 2022).

Overall, an ESG framework creates long-term value for companies and enhances investor and stakeholder confidence. Therefore, robust ESG implementation is believed to improve company performance, both financially and in terms of market value. Based on the theoretical arguments and empirical evidence discussed above, ESG Performance is expected to enhance Firm Performance by improving operational efficiency, strengthening stakeholder trust, reducing business risks, and creating sustainable long-term value. Therefore, the following hypothesis is proposed:

*$H_1$: ESG Performance has a positive and significant effect on Firm Performance in Indonesian.*

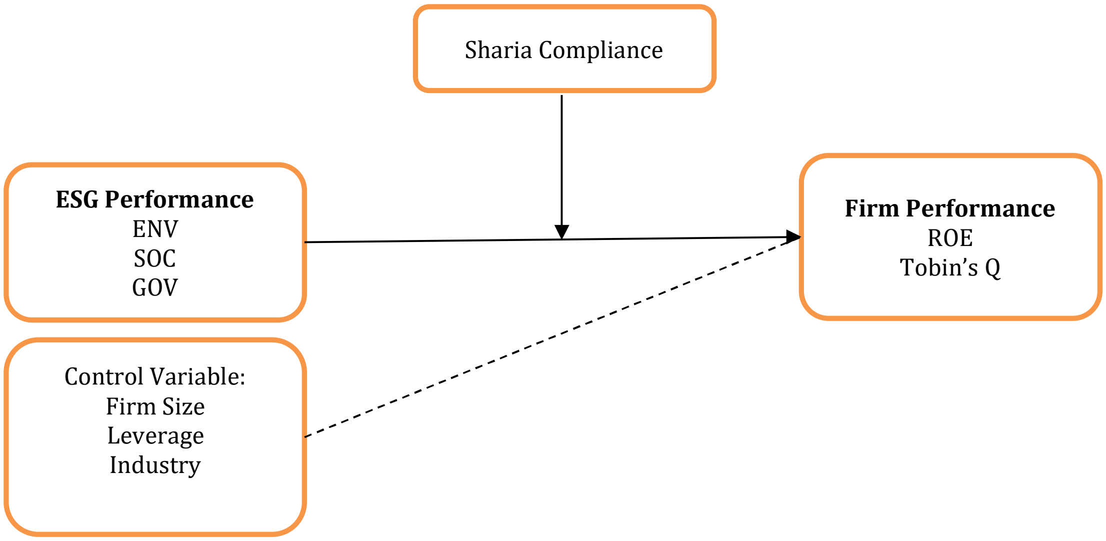
**The Role of Sharia Compliance as a Moderating variable between ESG Performance and Firm Performance**

Sharia compliance acts as a moderating variable that strengthens the relationship between ESG performance and firm performance. This concept is based on the principle that companies operating in accordance with sharia have a stronger ethical and governance foundation, thereby increasing investor credibility and trust. Asni et al. (2024) found that sharia compliance status strengthens the positive relationship between ESG performance and firm performance in Malaysia. Sharia compliance can also serve as a signal of good reputation for investors who prioritize ethical values in investment decisions. Thus, the presence of sharia compliance not only strengthens ESG practices but also drives improvements in a company's financial performance and market value. Accordingly, companies that implement ESG compliance while maintaining Sharia Compliance are expected to achieve stronger Firm Performance than companies with ESG practices alone. Therefore, the following hypothesis is formulated:

*$H_2$: Sharia Compliance moderating the relationship between ESG Performance and Firm Performance in Indonesian.*

**Research Framework**

A research framework is a conceptual illustration used to explain the relationships among the variables examined in a study. This framework serves as a guide for understanding how the independent variable, moderating variable, and control variables interact in influencing the dependent variable. In this study, the researcher examines the effect of ESG Performance on Firm Performance, measured by Return on Equity (ROE) and Tobin's Q. Furthermore, Sharia Compliance is incorporated as a moderating variable to assess whether it strengthens or weakens the relationship between ESG Performance and Firm Performance. To improve the robustness of the analysis, Firm Size, Leverage, and Industry are included as control variables. The conceptual framework of this study is presented in Figure 1.




Source: Author's own Work, 2026

**Figure 1**
**Research Framework**

## METHOD

This study uses a quantitative approach with explanatory research. It aims to analyze the relationship between ESG Performance and Firm Performance and evaluate the role of Sharia Compliance as a moderating variable. The explanatory approach is used because this research focuses on testing hypotheses based on theory and previous empirical findings, thus providing a systematic explanation of the direction and strength of the relationship between variables.

Quantitative approaches are widely used in ESG research because they allow for objective measurement of a company's sustainability performance and its impact on financial performance through statistical analysis based on numerical data (D. T. Nguyen et al., 2022). Furthermore, quantitative research with an explanatory design is considered appropriate for testing causal relationships between non-financial variables such as ESG and financial variables such as Tobin's Q and ROE (Wu et al., 2022).

The use of an explanatory research design also aligns with research by Pulino et al., (2022) and Fu et al. (2024) which emphasizes that the influence of ESG on firm performance needs to be empirically tested through regression models to obtain valid and generalizable conclusions. Furthermore Zheng and Bu (2024) state that ESG research using a quantitative and explanatory approach can more accurately capture the dynamics of the relationship between ESG and firm performance, especially when using panel data.

In the context of Islamic companies, an explanatory research approach is also relevant to examine the role of Sharia compliance as a factor that can strengthen or weaken the relationship between ESG performance and firm performance. This aligns with the findings of Nik et al. (2024) and Pujiastuti et al., (2024) who used a quantitative explanatory approach to examine the moderating effect of Sharia compliance on the relationship between ESG and firm performance.

**Table 1**
**Variable Definition**

| Variable | Variable Name | Description | Source |
|---|---|---|---|
| Dependent Variable | ROE | ROE measures profitability against shareholders' equity | Zalukhu & Palupiningyas, (2025) |
| | Tobins'Q | Tobin's Q measures the market value relative to an asset | Bui & Nguyen, (2023) |
| Independent Variable | ESG Performance | ESG Performance reflects environmental, social, and governance performance | Christiawan et al., (2026) |
| Moderation Variable | Sharia Compliance | Sharia compliance reflects a company's compliance with sharia principles. | Firdaus et al., (2025) |
| Control Variable | Firm Size | Firm size reflects the scale of the company based on total assets | Ghofar et al., (2025) |
| | Leverage | Leverage measures the proportion of debt to a company's assets. | Valencia, (2025) |

Table 2 presents the distribution of our sample. Purposive sampling was conducted based on the availability of ESG Performance data, company financial data, and Sharia Compliance information for the 2019–2024 period. The sample was selected because only companies that met these criteria could be used to test the effect of ESG Performance on Firm Performance and the moderating role of Sharia Compliance. The percentage of observations from each industry in Indonesia is Real Estate, 6.89%; Financial 16.07%; Consumer Staples 15.41%; Materials 16.07; Health care 1.97%; Information Technology 2.3%; Energy 8.52%; Industrial 9.18%; Consumer Discretionary 4.26%; Communication Services 16.39%; and Utilities 2.95%.

**Table 2**
**Sample Distribution**

| Industry | Sharia Sample | Non-Sharia Sample | Total | % |
|---|---|---|---|---|
| Real estate | 21 | 0 | 21 | 6.89% |
| Financial | 4 | 45 | 49 | 16.07% |
| Consumer Staples | 33 | 14 | 47 | 15.41% |
| Materials | 43 | 6 | 49 | 16.07% |
| Health care | 6 | 0 | 6 | 1.97% |
| Information Technology | 7 | 0 | 7 | 2.30% |
| Energy | 26 | 0 | 26 | 8.52% |
| Industrial | 13 | 15 | 28 | 9.18% |
| Consumer Discretionary | 13 | 0 | 13 | 4.26% |
| Communication Services | 32 | 18 | 50 | 16.39% |
| Utilities | 9 | 0 | 9 | 2.95% |
| Total observations | 207 | 98 | 305 | 100.00% |

Source: Data were processed by researchers using Stata 19, 2026

**Empiricals models**

To test the influence of ESG Performance on Firm Performance and the moderating role of Sharia Compliance, the empirical model in this study is formulated as follows:

$$ROEit = \beta 0 + \beta 1ESGit + \beta 2LEVit + \beta 3SIZEit + IndustryFE + YearFE + \varepsilon it$$

$$ROEit = \beta 0 + \beta 1ESGit + \beta 2SCit + \beta 3(ESG \times SC)it + \beta 4LEVit + \beta 5SIZEit + IndustryFE + YearFE + \varepsilon it$$

$$TobinQit = \beta 0 + \beta 1ESGit + \beta 2LEVit + \beta 3SIZEit + IndustryFE + YearFE + \varepsilon it$$

$$TobinQit = \beta 0 + \beta 1ESGit + \beta 2SCit + \beta 3(ESG \times SC)it + \beta 4LEVit + \beta 5SIZEit + IndustryFE + YearFE + \varepsilon it$$

Description:

- ROE_it = Return on Equity of company i in year t
- TobinQ_it = Tobin's Q of company i in year t
- ESG_it = ESG Performance score of company i in year t
- SC_it = Sharia Compliance of company i in year t
- (ESG×SC)_it = interaction variable between ESG Performance and Sharia Compliance as a moderating variable
- LEV_it = Leverage of company i in year t
- SIZE_it = Firm Size of company i in year t
- IndustryFE = industry fixed effect to control for differences in characteristics between industrial sectors
- YearFE = year fixed effect to control for changes in economic conditions between study periods
- β_0 = constant
- β_1-β_5 = regression coefficient
- ε_it = error term

**RESULTS AND DISCUSSION**

**Data Analysis**

A mixed sample of sharia and non-sharia companies, with 305 company observations from 2019 to 2024. Table 3 presents descriptive statistics for the variables used in the analysis, categorized by company type. The ROE of sharia companies is higher than that of non-sharia companies.

**Table 3**
**Descriptive statistics**

| | N | Mean | Standard Deviation | Minimum | Maximum |
|---|---|---|---|---|---|
| ESGPERFORMANCE | 305 | 51.381 | 18.693 | 14.127 | 87.132 |
| ROE | 305 | 0.151 | 0.290 | -0.573 | 1.571 |
| TobinsQ | 305 | 1.997 | 4.049 | 0.279 | 33.613 |
| Sharia Compliance | 305 | 0.692 | 0.463 | 0.000 | 1.000 |
| Lev | 305 | 0.510 | 0.227 | 0.112 | 0.937 |
| FirmSize | 305 | 31.544 | 1.800 | 22.577 | 35.214 |

Source: Author's own work, 2026

The ESG Performance variable has an average value of 51.381 with a standard deviation of 18.693. This indicates that ESG Performance is in the medium category with relatively high variation between companies. The minimum value of 14.127 and the maximum value of 87.132 indicate a gap in ESG implementation among companies. This finding aligns with research Nilawati (2025) which states that ESG implementation in Indonesia remains uneven and shows significant variation between companies.

The Return on Equity (ROE) variable showed an average value of 0.151 with a standard deviation of 0.290. The lowest value of -0.573 indicates a company experiencing losses, while the highest value of 1.571 reflects a company with a very high level of profitability. This indicates that the financial performance of the companies in the sample is quite diverse. These results are supported by research Adriani and Parinduri (2024) which states that company profitability is influenced by various internal and external factors, thus tending to fluctuate.

Furthermore, Tobin's Q variable showed an average value of 1.097 with a standard deviation of 4.049. The lowest value of 0.279 and the highest of 33.613 indicate a significant difference in market valuation of the company. An average value greater than 1 indicates that the company generally has good growth prospects in the eyes of investors. However, previous research has shown mixed results in the relationship between ESG and company value (Nafisah, 2025).

The Sharia Compliance variable has an average value of 0.692 with a standard deviation of 0.463. A minimum value of 0 and a maximum value of 1 indicate that this variable is a dummy variable. A mean value close to 1 indicates that the majority of companies in the sample have met the Sharia compliance criteria, reflecting the increasing adoption of Sharia principles in the Indonesian capital market company's funding structure.

Meanwhile, the Firm Size variable has an average value of 31.544 with a standard deviation of 1.800, indicating that the company size in the sample is relatively large with a moderate level of variation. Company size is also known to play a role in influencing the relationship between ESG and company value (Nafisah, 2025).

Table 4 presents the Pearson correlation matrix results for ESG Performance, ROE, Tobin's Q, Sharia Compliance, Firm Size, and Leverage. The results show a positive and significant correlation between ROE and ESG Performance, indicating that the higher a company's ESG performance, the higher its profitability. This finding aligns with research showing that sound ESG practices contribute to improved corporate financial performance (Temalagi et al., 2025).

**Table 4**
**Pearson Corellation**

| | ESGPERFORMANCE | ROE | TobinsQ | ShariaCompliance | Lev | FirmSize |
|---|---|---|---|---|---|---|
| ESGPERFORMANCE | 1.000 | | | | | |
| ROE | 0.222*** | 1.000 | | | | |
| | (0.000) | | | | | |
| TobinsQ | -0.073 | 0.213*** | 1.000 | | | |
| | (0.201) | (0.000) | | | | |
| ShariaCompliance | -0.052 | 0.116** | -0.138** | 1.000 | | |
| | (0.364) | (0.044) | (0.016) | | | |
| Lev | 0.111* | 0.116** | 0.113** | -0.589*** | 1.000 | |
| | (0.052) | (0.042) | (0.049) | (0.000) | | |
| FirmSize | 0.238*** | -0.044 | -0.166*** | -0.371*** | 0.348*** | 1.000 |
| | (0.000) | (0.447) | (0.004) | (0.000) | (0.000) | |

*p*-values in parentheses
* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

However, ESG performance did not significantly correlate with Tobin's Q or Sharia Compliance. This suggests that improved ESG performance may not necessarily translate directly into increased firm value. This finding is consistent with previous research, which found that the relationship between ESG and firm value shows mixed and insignificant results (Handayani et al., 2025) as well as a weak correlation between ESG and Tobin's Q (Alfredo et al., 2025).

Furthermore, ROE has a positive and significant correlation with Sharia Compliance, indicating that companies that comply with Sharia principles tend to have better profitability. Sharia compliance companies with good sustainability practices tend to have higher financial performance.

Meanwhile, Tobin's Q has a negative and significant correlation with Sharia Compliance, indicating that companies that comply with Sharia principles tend to have lower market values. This could be due to limited investment or investor perceptions of Sharia compliance companies. The implementation of ESG or sustainability principles does not always have a positive impact on company value; in some cases, it can even show a negative relationship.

Regression analysis Table 5 presents the estimated regression results assessing the effect of ESG performance on ROE and Tobin's Q, as well as the moderating role of Sharia compliance. Models 1 and 2 use ROE as the dependent variable, while models 3 and 4 use Tobin's Q.

**Table 5**
**Regression Analysis**

| | (1) ROE | (2) ROE | (3) TobinsQ | (4) TobinsQ |
|---|---|---|---|---|
| ESGPERFORMANCE | 0.004*** | -0.000 | 0.002 | -0.039* |
| | (4.01) | (-0.26) | (0.13) | (-1.73) |
| Lev | 0.352*** | 0.490*** | 3.006*** | 2.068 |
| | (2.94) | (3.56) | (3.11) | (1.52) |

| | | | | |
|---|---|---|---|---|
| FirmSize | -0.007 | -0.000 | -0.602** | -0.528*** |
| | (-0.60) | (-0.04) | (-2.55) | (-3.44) |
| ShariaCompliance | | -0.160** | | -4.794*** |
| | | (-2.28) | | (-3.24) |
| ESGPERFORMANCE* SHARIA COMPLIANCNE | | 0.007*** | | 0.075** |
| | | (3.80) | | (2.57) |
| _cons | -0.065 | -0.263 | 18.590** | 17.947*** |
| | (-0.20) | (-0.89) | (2.54) | (2.92) |
| INDUSTRY FE | Yes | Yes | Yes | Yes |
| Year FE | Yes | Yes | Yes | Yes |
| r2 | 0.332 | 0.385 | 0.169 | 0.200 |
| r2_a | 0.287 | 0.340 | 0.114 | 0.141 |
| *N* | 305 | 305 | 305 | 305 |

*t statistics in parentheses*
** p < 0.1, ** p < 0.05, *** p < 0.01*

In model 1, ESG performance shows a positive and significant coefficient on ROE ($\beta = 0.004$; $p < 0.01$). Alfredo et al. (2025) indicate that increased ESG performance contributes to increased company profitability. The control variable leverage also has a positive and significant effect, while firm size does not show a significant effect on ROE.

In model 2, after Sharia Compliance moderated, ESG Performance no longer had a significant effect on ROE ($\beta = -0.000$; not significant). Conversely, Sharia Compliance showed a negative and significant effect on ROE ($\beta = -0.160$; $p < 0.05$). Nevertheless, sharia compliance showed a moderation of sharia compliance on ESG Performance and ROE which showed a positive and significant coefficient ($\beta = 0.007$; $p < 0.01$), which means that sharia compliance strengthens the relationship between ESG Performance and ROE.

In model 3, ESG Performance does not significantly influence Tobin's Q ($\beta = 0.002$; not significant). Leverage has a positive and significant effect on firm value, while firm size shows a negative and significant effect ($\beta = -0.602$; $p < 0.05$), indicating that larger firms tend to have lower market values.

In model 4, ESG Performance shows a negative and significant effect on Tobin's Q ($\beta = -0.039$; $p < 0.1$), indicating that the market responds negatively to increasing ESG. Sharia compliance also has a negative and significant effect on firm value ($\beta = -4.794$; $p < 0.01$). However, the interaction variable shows a positive and significant result ($\beta = 0.075$; $p < 0.05$), indicating that Sharia compliance strengthens the influence of ESG on firm value.

## Discussion

First, ESG Performance was shown to have a positive and significant impact on company profitability, as measured by Return on Equity (ROE). This indicates that implementing sound sustainability practices can improve a company's internal financial performance. However, ESG Performance did not significantly impact firm value, as measured by Tobin's Q, and in some models, it even showed a negative effect. This finding indicates that the market has not yet fully responded positively to ESG information, resulting in ESG benefits being felt more internally by the company than by market perception (Firmansyah et al., 2023).

Second, Sharia Compliance has a negative impact on Firm Performance, both in terms of profitability and market value. This indicates that companies that adhere to Sharia principles tend to face certain limitations, such as investment restrictions or financial structure constraints, which can influence financial performance and investor perceptions. Prior literature suggests that Sharia screening may reduce investment flexibility and narrow financing opportunities, thereby affecting firm performance in certain contexts (Pujiastuti et al., 2024).

Third, although Sharia Compliance has a direct negative effect, this variable has been shown to act as a moderation, strengthening the relationship between ESG Performance and Firm Performance. The interaction results indicate that the combination of ESG implementation and Sharia compliance can improve Firm Performance, both in terms of profitability and firm value. In other words, the added value of ESG is maximized when accompanied by Sharia principles that emphasize ethics, transparency, and good governance (Pujiastuti et al., 2024; Alfikri, 2025).

## CONCLUSION AND SUGGESTION

This study aims to examine the influence of Environmental, Social, and Governance (ESG) Performance on Firm Performance, while also examining the role of Sharia Compliance as a moderating variable in Indonesian companies. Based on empirical analysis of 305 company observations from 2019–2024, several key findings were obtained.

Theoretically, this study supports stakeholder theory and legitimacy theory, which state that sustainability practices and compliance with social norms (including Sharia principles) can enhance legitimacy and stakeholder trust. Practically, these findings provide implications for corporate management to focus not only on ESG implementation but also on the quality of Sharia principles implementation to create long-term value. For investors, these findings are important considerations in evaluating ESG and Sharia-based investments.

This study has several limitations, including the relatively limited observation period and the dummy-based measurement of Sharia Compliance, which in turn fails to capture the level of compliance in greater depth. Therefore, future research is recommended to use a longer period, expand the sample, and develop a more comprehensive measurement of Sharia Compliance. Furthermore, further research could consider other variables such as governance quality, corporate risk, or macroeconomic factors to provide a more holistic understanding of the relationship between ESG performance and firm performance.

Future studies are recommended to employ a longer observation period, include a larger sample across different countries, and utilize more comprehensive measures of Sharia compliance rather than a dummy variable. In addition, future research may examine other moderating or mediating variables, such as corporate governance quality, innovation capability, institutional ownership, or macroeconomic conditions, to provide a deeper understanding of the relationship between ESG performance and firm performance.

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