

DO ESG AND BOARD STRUCTURE IMPROVE FINANCIAL PERFORMANCE? EVIDENCE FROM INDONESIAN FAMILY FIRMS



<https://journal.unpas.ac.id/index.php/jrak/index>

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Article Info

History of Article

Received: 13/5/2026

Revised: 8/9/2026

Accepted: 11/9/2026

Available Online: 27/10/2026

Jurnal Riset Akuntansi Kontemporer

Volume 18, No. 2, October 2026,

Page 272-289

ISSN 2088-5091 (Print)

ISSN 2597-6826 (Online)

 <https://doi.org/10.23969/jrak.v18i2.48326>

Keywords: board structure; esg; family firms; governance; indonesia; profitability

Abstract

The consideration of socioemotional wealth in Indonesian family firms might create tension between sustainability and economic objectives. This study aims at examining how environmental, social, and governance (ESG) performance and board structure affect the financial performance of Indonesian family firms. Drawing on the resource-based view and socioemotional wealth perspective, ESG is conceptualised as a strategic capability, and board structure represents a governance mechanism that shapes its effectiveness. Panel data were used from family firms listed on the Indonesia Stock Exchange between 2011 and 2023, with firm and year fixed effects; the results showed that both ESG performance and board structure positively influence profitability. Moreover, the positive effect of ESG is stronger in firms with smaller boards, suggesting that more cohesive governance enhances the implementation of ESG strategies and their financial benefits. Ultimately, these findings highlight the importance of governance in enabling family firms to realise greater value from ESG, particularly in emerging markets.

INTRODUCTION

The integration of environmental, social, and governance (ESG) practices into corporate strategy has become a defining feature of modern business, particularly in emerging markets where regulatory expectations and stakeholder demand continue to increase. In Indonesia, ESG has evolved from voluntary disclosure into an increasingly mandatory corporate practice following the implementation

of OJK Regulation No. 51/POJK.03/2017, the Indonesia Sustainable Finance Roadmap, and sustainability reporting guidance issued by the Indonesia Stock Exchange (IDX). These regulatory developments have accelerated ESG adoption among listed companies and stimulated a growing body of Indonesian research examining the economic consequences of sustainability practices (e.g., Buallay, 2019; Saidi et al., 2025; Sari et al., 2025; Angir & Weli, 2024; Sastroredjo et al., 2026).

Existing evidence from Indonesia generally suggests that ESG disclosure and governance practices are associated with higher firm value, profitability, and investor confidence. However, the findings remain inconclusive because most studies focus on all listed firms, manufacturing firms, financial institutions, or state-owned enterprises (Saidi et al., 2025; Sari et al., 2025), while family firms receive considerably less attention (Waldau, 2024). Moreover, previous Indonesian studies have mainly examined the direct relationship between ESG and firm performance (Rahmaniati & Ekawati, 2024), with limited attention to the governance mechanisms through which ESG generates financial value.

This gap matters because family firms dominate Indonesia's corporate landscape and differ fundamentally from non-family firms in their strategic objectives. Besides pursuing financial returns, family firms are looking to preserve socioemotional wealth (SEW), including family control, reputation, and intergenerational continuity (Berrone et al., 2012). Consequently, ESG investments might either improve financial performance by strengthening stakeholder relationships or reduce profitability when sustainability initiatives are implemented primarily for symbolic legitimacy rather than strategic value creation (Ma, 2024).

The issue has become increasingly urgent as Indonesian companies face growing regulatory and market pressure to integrate ESG into their business strategies while maintaining financial performance. Although ESG reporting has expanded substantially, implementation quality varies considerably across firms. This raises an important question of whether ESG genuinely improves firm performance and whether board structure enables family firms to translate sustainability initiatives into superior financial outcomes. Addressing this question is important for managers, investors, and policymakers seeking to strengthen sustainable corporate governance in Indonesia.

To explain these relationships, this study integrates the resource-based view (RBV) and the socioemotional wealth (SEW) perspective. The RBV suggests that ESG represents a strategic capability that strengthens stakeholder relationships, reputational capital, and long-term competitiveness when effectively deployed (Bhandari et al., 2022). However, firm-specific capabilities create value only when supported by appropriate organisational structures and governance mechanisms (Asija & Ringov, 2021). The SEW perspective complements this argument by recognising that family firms often prioritise non-financial objectives, including family reputation, continuity, and control (Berrone et al., 2012). While these objectives might encourage ESG adoption, they also result in symbolic implementation that fails to improve financial performance. Accordingly, ESG is expected to create value only when supported by governance structures capable of aligning sustainability initiatives with organisational objectives.

Board structure represents one of the most important governance mechanisms through which family firms coordinate strategic resources and sustainability initiatives. Smaller boards generally facilitate clearer accountability, faster decision-making, and stronger strategic alignment, enabling ESG practices to become embedded within organisational routines (Disli et al., 2022). In contrast, larger boards might experience coordination difficulties, slower strategic responses, and diluted accountability, reducing the effectiveness of ESG implementation (Treepongkaruna et al., 2024). Consequently, board structure might not only influence firm performance directly but also determine how effectively ESG initiatives are translated into financial outcomes.

From this perspective, this study pursues three research objectives. First, it examines whether ESG performance enhances the financial performance of Indonesian family firms. Second, it investigates whether board structure influences firm performance. Third, it examines whether board structure moderates the relationship between ESG performance and financial performance by facilitating the effective implementation of ESG strategies. Moreover, using panel data on Indonesian family firms listed on the Indonesia Stock Exchange between 2011 and 2023, this study provides one of the first large-sample examinations of ESG and financial performance in this context. Additionally,

because no official registry of family firms exists in Indonesia, this study develops a transparent, manually validated procedure for identifying family ownership, providing a replicable approach for future research in data-constrained environments.

This study contributes to the literature in three ways. First, it examines the direct effects of ESG performance and board structure on firm performance while demonstrating that the financial benefits of ESG depend on governance quality. Second, it integrates the resource-based view and socioemotional wealth perspective to explain how governance transforms ESG from a sustainability initiative into a value-creating organisational capability. Third, it provides new evidence from Indonesian family firms, extending ESG research in emerging markets where institutional development and governance quality jointly shape corporate sustainability outcomes.

The remainder of the paper develops the theoretical framework and hypotheses, outlines the research design and empirical strategy, presents the results and robustness analyses, and concludes with implications and suggestions for future research.

Accordingly, the following hypotheses are as follows.

- H1: ESG performance is positively associated with the financial performance of Indonesian family firms.
- H2: Board structure is positively associated with the financial performance of Indonesian family firms.
- H3: The positive relationship between ESG performance and financial performance is stronger among family firms with smaller boards.

METHOD

This study examines the relationship between ESG performance and profitability among family firms listed on the Indonesia Stock Exchange (IDX) from 2011 to 2023. ESG, financial, and governance data are obtained from Refinitiv Eikon and cross-checked against annual reports and IDX filings to ensure data reliability. The sample period begins in 2011 because ESG coverage for Indonesian listed firms in Refinitiv Eikon becomes sufficiently available from that year onward, allowing for consistent longitudinal analysis. The analysis concludes with fiscal year 2023 because the dataset was collected during 2024, when complete and verified financial statements and ESG information for subsequent years were not yet fully available through the database to which the authors had institutional access. Consequently, the 2011–2023 period represents the most comprehensive and reliable dataset available at the time of the study. As neither the IDX nor the OJK provides an official registry of family firms, family control is identified through a manual verification process based on ownership disclosures, annual reports, and investor relations materials. Consistent with established definitions, a firm is classified as family-controlled when (i) a founding family holds at least 20% of equity, directly or indirectly, and (ii) family members are involved in management or board positions (Anderson & Reeb, 2003; Miller & Le Breton-Miller, 2006).

Firms are grouped using the Fama–French 12 industry classification derived from SIC codes. Financial and utilities firms are retained to capture the full spectrum of ESG adoption across Indonesian family businesses. After excluding observations with incomplete ESG or financial data, the final unbalanced panel comprises 205 firm-year observations (see Table 1). Following common practice in accounting and finance research, all continuous financial variables are winsorised at the 1st and 99th percentiles to reduce the influence of extreme observations. Governance variables, such as board size, are not winsorised because they are discrete count variables, while ESG scores are not winsorised because they are bounded index-based measures with predefined scales. Consequently, winsorisation was applied only to continuous financial variables that are more susceptible to the influence of extreme values.

To address potential endogeneity concerns such as simultaneity bias, whereby highly profitable firms might have more financial slack to invest in ESG, our empirical strategy relies on panel fixed-effects regressions and entropy-balancing estimators. These techniques help control for unobserved firm-level characteristics and selection bias, supporting the directional sequence implied by the Resource-Based View that strategic ESG capabilities contribute to financial performance.

Table 1. Distribution of studied cases by year and industry. Panel A: Distribution by Year

Year	Freq.	Percent	Cum.
2011	7	3.41	3.41
2012	9	4.39	7.80
2013	11	5.37	13.17
2014	13	6.34	19.51
2015	13	6.34	25.85
2016	14	6.83	32.68
2017	16	7.80	40.49
2018	17	8.29	48.78
2019	17	8.29	57.07
2020	18	8.78	65.85
2021	21	10.24	76.10
2022	24	11.71	87.80
2023	25	12.20	100.00
Total	205	100.00	

Table 1. Panel B: Distribution by Industry based on Standard Industrial Classification (SIC) Codes.

	Freq.	Percent	Cum.
Consumer Nondurables	30	14.63	14.63
Manufacturing	14	6.83	21.46
Oil, Gas, and Coal Extraction and Products	20	9.76	31.22
Chemicals and Allied Products	6	2.93	34.15
Telephone and Television Transmission	39	19.02	53.17
Wholesale, Retail, and Services	43	20.98	74.15
Healthcare, Medical Equipment, and Drugs	13	6.34	80.49
Other	40	19.51	100.00
Total	205	100.00	

Table 1 provides an overview of the sample composition. Panel A reports the annual distribution of the 205 firm-year observations from 2011 to 2023 and shows a marked increase in ESG reporting among Indonesian family firms over time. ESG coverage was relatively limited in the early years (2011–2014), reflecting the nascent stage of sustainability disclosure. A pronounced rise occurs after 2017, following the introduction of OJK Regulation No. 51/POJK.03/2017 and SEOJK 16/2021, which formalised sustainability reporting requirements. The upward trend continues through 2020–2023, which accounts for approximately 43% of the sample, indicating both heightened stakeholder attention and improved ESG data availability in Refinitiv Eikon.

Table 1, Panel B, presents the sectoral distribution of the sample. Observations are concentrated in wholesale, retail, and services (20.98%), telecommunications and broadcasting (19.02%), and diversified sectors (19.51%), with additional representation from consumer nondurables, extractive industries, and manufacturing. This spread suggests that ESG adoption in Indonesia extends beyond traditionally regulated or resource-intensive sectors to service- and technology-oriented industries,

where reputational and stakeholder pressures are also influential. All variable definitions and measurements used in the analysis are presented in Table 2.

The primary dependent variable is the firm's profitability, measured by Return on Equity (ROE), which assesses the company's ability to generate income relative to shareholders' equity and indicates how effectively ESG engagement is translated into value for shareholders and other stakeholders. ROE is particularly appropriate in family firms, where retained earnings and internal financing play a central role in sustaining long-term investment. As a robustness check, Return on Assets (ROA) is employed to assess earnings generated from total asset utilisation. Using both measures ensures that the observed relationship between ESG and profitability is not solely driven by equity structure or ownership concentration (Friede et al., 2015; Buallay, 2019; Albitar et al., 2020).

The primary independent variable, ESG performance, is proxied by the Refinitiv ESG Score (0–100), which aggregates firm-level performance across the environmental, social, and governance pillars. Following prior research (Friede et al., 2015; Albitar et al., 2020), this composite indicator captures both disclosure quality and quantitative outcomes, with higher scores indicating more comprehensive and effective ESG implementation. To minimise multicollinearity among closely related financial indicators, this study includes four control variables: sales growth (SG), free cash flow (FCF), leverage (LEV), and firm size (SIZE).

Sales growth captures expansion and market competitiveness, allowing us to distinguish profitability driven by operational scaling from that associated with ESG engagement (Anderson & Reeb, 2003; Buallay, 2019). In family firms, growth is often driven by a focus on long-term goals and risk avoidance, underscoring the need to distinguish between performance gains from market expansion and those from sustainability initiatives. Free cash flow reflects internal liquidity available for reinvestment and strategic activities, including ESG initiatives. This is particularly relevant in family firms, which tend to rely heavily on internal financing and might prioritise financial flexibility to preserve control and independence (Albitar et al., 2020).

Leverage, measured as total debt divided by total assets, captures the firm's financial risk and reliance on external financing (D'Amico et al., 2024; Feng et al., 2024; Jiang et al., 2024; Souguir et al., 2024). In family firms, leverage might constrain ESG investments, which often require long-term commitment and uncertain payoffs, or incentivise firms to engage in ESG to signal credibility and reduce perceived risk among creditors. Firm size, measured as the natural logarithm of total assets, controls for scale-related resources, visibility, and the capacity to absorb ESG costs. Larger family firms are more likely to face stakeholder scrutiny and possess the organisational capacity to implement ESG practices effectively (Berrone et al., 2012).

The authors analyse one governance variable, board size, as a moderator of the relationship between ESG performance and profitability, reflecting how decision-making structures influence family firms' ability to translate sustainability initiatives into financial results. **Board size was also examined** as a governance mechanism that moderates the relationship between ESG performance and profitability, reflecting how decision-making structures influence family firms' ability to translate sustainability initiatives into financial outcomes. Aligned with Indonesian corporate governance practice, board size is measured as the **total number of members serving on the Board of Directors** at the end of each fiscal year. The Board of Directors is responsible for managing the company's day-to-day operations and implementing strategic decisions, making it the most relevant governance body for evaluating the execution of ESG initiatives. Data on board composition were obtained from **Refinitiv Eikon** and verified using firms' annual reports and corporate governance disclosures filed with the Indonesia Stock Exchange (IDX) to ensure accuracy and consistency. To examine the moderating role of board size, firms were classified into **smaller-board and larger-board groups based on the sample median**, and separate subsample regressions were estimated. Smaller boards are generally associated with clearer accountability, faster decision-making, and more efficient implementation of strategic initiatives (Coles et al., 2008), whereas larger boards may experience coordination difficulties and diluted responsibility, potentially reducing the effectiveness of ESG implementation (Ahrens et al., 2026).

Table 2. Variables Definition

Dependent Variables	Description
Return on equity (ROE)	measured as the net income for the fiscal period divided by the total equity
Return on assets (ROA)	measured as the net income for the fiscal period divided by the total assets
Independent Variables	
Environment, Social, and Governance Score (ESG)	Reflects the overall score based on the self-reported information in the environmental, social, and governance pillars. (accessed on April 01, 2025, https://eikon.refinitiv.com/)
Control Variables	
Sales Growth (SG)	measured as current sales minus prior sales divided by prior sales
Size (SIZE)	measured as the natural logarithm of total assets
Free Cash Flow (FCF)	measured as cash flow from operations divided by sales
Leverage (LEV)	measured as total debt divided by total assets
Moderating Variables	
Board Size	measured as the number of board members

Note: All data were extracted from the Refinitiv Eikon source, accessed on <https://eikon.refinitiv.com/>

To test the three hypotheses, we estimate a series of panel regression models incorporating the relevant explanatory variables, control variables, and both industry and year fixed effects. The models examine the direct effects of ESG performance and board structure on firm performance, as well as the moderating role of board structure in the relationship between ESG performance and firm performance.

Here is the model to test hypothesis 1:

$$ROE_{it} = \beta_0 + \beta_1 ESG_{it} + \beta_2 SG_{it} + \beta_3 FCF_{it} + \beta_4 LEV_{it} + \beta_5 SIZE_{it} + Industry FE + Year FE + \varepsilon_{it} \quad (1)$$

Here is the model to test hypothesis 2:

$$ROE_{it} = \beta_0 + \beta_1 BODSIZE_{it} + \beta_2 SG_{it} + \beta_3 FCF_{it} + \beta_4 LEV_{it} + \beta_5 SIZE_{it} + Industry FE + Year FE + \varepsilon_{it} \quad (2)$$

Here is the model to test hypothesis 3 for the large boards (Board Size = 1):

$$ROE_{it}^{(Board Size = 1)} = \alpha_0 + \alpha_1 ESG_{it}^{(Board Size = 1)} + \alpha_2 SG_{it}^{(Board Size = 1)} + \alpha_3 FCF_{it}^{(Board Size = 1)} + \alpha_4 LEV_{it}^{(Board Size = 1)} + \alpha_5 SIZE_{it}^{(Board Size = 1)} + Industry FE + Year FE + \varepsilon_{it} \quad (3)$$

Here is the model to test hypothesis 3 for the small boards (Board Size = 0):

$$ROE_{it}^{(Board Size = 0)} = \alpha_0 + \alpha_1 ESG_{it}^{(Board Size = 0)} + \alpha_2 SG_{it}^{(Board Size = 0)} + \alpha_3 FCF_{it}^{(Board Size = 0)} + \alpha_4 LEV_{it}^{(Board Size = 0)} + \alpha_5 SIZE_{it}^{(Board Size = 0)} + Industry FE + Year FE + \varepsilon_{it} \quad (4)$$

RESULTS

Table 3 presents the descriptive statistics for the sample of 205 firm-year observations of Indonesian family firms. Firm performance, measured by profitability, shows a mean ROE of 16.46% and a mean ROA of 9.76%, indicating generally positive returns to both shareholders and assets. The

wider dispersion in ROE relative to ROA suggests that equity-based returns are more volatile and more sensitive to differences in capital structure. The mean ESG score is 37.26, with a range of 7.44 to 88.55, indicating moderate but heterogeneous ESG engagement across firms. This variation suggests that while some family firms have adopted sustainability practices more extensively, others remain at an earlier stage of ESG implementation.

Table 3. Summary Statistics

	N	Mean	SD	Min	Median	Max
ROE	205	16.46	19.044	-130.894	15.780	104.272
ROA	205	9.755	8.195	-18.023	8.547	43.320
ESG	205	37.26	17.478	7.443	35.516	88.545
SG	205	0.095	0.189	-0.448	0.079	1.075
FCF	205	0.140	0.152	-0.476	0.133	0.529
LEV	205	0.218	0.133	0.000	0.231	0.582
SIZE	205	31.329	0.962	29.020	31.287	33.321
BODSIZE	205	6.025	2.247	3.000	6.000	15.000

Among the control variables, average sales growth is 9.5%, while average free cash flow is 14.0%, reflecting moderate growth and strong internal liquidity. Leverage has a mean of 21.8%, consistent with the relatively conservative financing behaviour often associated with family firms seeking to preserve control. Firm size shows limited dispersion, indicating a relatively comparable sample of listed firms. Finally, the mean board size is 6 directors, suggesting that most Indonesian family firms maintain relatively compact boards, which may support concentrated oversight and efficient decision-making.

Table 4 explains the Pearson correlation matrix, focusing on the associations with ESG. ESG is negatively and significantly correlated with leverage (-0.290 , $p < 0.01$), indicating that firms with lower debt levels tend to exhibit stronger ESG performance. This suggests that financially less constrained family firms may be better positioned to undertake sustainability initiatives. ESG is positively and significantly associated with firm size (0.254 , $p < 0.01$), implying that larger firms are more likely to engage in ESG practices, possibly due to greater resources, stronger disclosure incentives, and higher stakeholder scrutiny. In addition, ESG is positively related to board size (0.133 , $p < 0.10$), suggesting that firms with larger boards might possess broader governance capacity to support sustainability engagement.

Table 4. Pearson Correlation Matrix

Variables	ROE	ROA	ESG	SG	FCF	LEV	SIZE	BODSIZE
ROE	1.000							
ROA	0.818***	1.000						
ESG	0.107	0.038	1.000					
SG	0.456***	0.368***	0.054	1.000				
FCF	0.163**	0.274***	0.030	0.056	1.000			
LEV	-0.425***	-0.564***	-0.290***	-0.129*	-0.153**	1.000		
SIZE	-0.181***	-0.392***	0.254***	-0.008	-0.132*	0.395***	1.000	
BODSIZE	-0.108	-0.082	0.133*	0.018	-0.183***	0.204***	0.430***	1.000

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

Table 5 shows the Variance Inflation Factors (VIFs) used to assess multicollinearity among the independent variables. The mean VIF is 1.27, while the individual VIFs range from 1.02 to 1.50, all of which are well below the conventional threshold of 10 and the more conservative benchmark of 5.

Among the variables, leverage (LEV = 1.50) and firm size (SIZE = 1.45) exhibit the highest VIF values, followed by ESG (1.33), although these levels remain low and do not indicate problematic collinearity. Free cash flow (FCF = 1.03) and sales growth (SG = 1.02) show minimal overlap with the other regressors. These results suggest that multicollinearity is not a material concern in the regression models, indicating that the estimated coefficients are unlikely to be distorted by excessive correlation among the explanatory variables.

Table 5. Variance Inflation Factors (VIF)

Variable	VIF	1/VIF
LEV	1.50	0.665
SIZE	1.45	0.689
ESG	1.33	0.754
FCF	1.03	0.968
SG	1.02	0.979
MEAN VIF	1.27	

To test the proposed hypothesis, Eq. (1) is estimated to examine the relationship between ESG performance and firm performance, proxied by profitability, while controlling for firm characteristics, industry, and year fixed effects (See Table 6). In this study, firm performance is reflected by Return on Equity (ROE), which captures the firm's ability to generate earnings from its equity base. Model (1) includes sales growth (SG), free cash flow (FCF), leverage (LEV), and firm size (SIZE) as control variables, with year and industry fixed effects and industry-clustered standard errors to account for within-industry correlation.

Table 6. Regression Analysis Results of ESG and Profitability in Family Business (Hypothesis 1)

DV:	ROE
	Model 1
IV:	
ESG	0.222** (2.658)
CVs:	
SG	46.194* (2.215)
FCF	13.261** (2.739)
LEV	-57.601* (-2.040)
SIZE	-3.190 (-1.803)
Constant	132.753* (2.138)
Observations	205
Adjusted R-squared	0.429
Year Fixed Effect	YES
Industry Fixed Effect	YES
Cluster by Industry	YES

Note: Table 6 presents the baseline regression results for ESG performance on firm performance, measured by Return on Equity (ROE), which reflects firms' profitability. ESG is measured using the Refinitiv ESG Score (0–100), where higher scores indicate more comprehensive ESG implementation. A positive and significant coefficient on ROE indicates that higher ESG performance is associated with higher returns on equity. Control variables include sales growth (SG), free cash flow (FCF), leverage (LEV), and firm size (SIZE). Year and industry fixed effects are included to control for macroeconomic and sector-specific factors. Standard errors are clustered by industry. The ** and * denote significance at the 5% and 10% levels, respectively.

The regression results show a positive and statistically significant relationship between ESG performance and firm performance, proxied by Return on Equity (ROE). The coefficient on ESG ($\beta = 0.222$, $t = 2.658$) indicates that firms with higher ESG scores tend to generate higher returns for shareholders. This finding suggests that ESG engagement enhances firm performance not only through operational improvements but also by strengthening investor confidence and supporting long-term value creation. Among the control variables, sales growth ($\beta = 46.194$, $t = 2.215$) is positively associated with ROE, indicating that firms experiencing stronger expansion are better able to translate growth opportunities into shareholder returns. Free cash flow ($\beta = 13.261$, $t = 2.739$) also shows a positive and significant effect, suggesting that firms that possess higher internal liquidity are better positioned to finance strategic initiatives, including ESG investments, without diluting shareholder value. The model demonstrates moderate explanatory power (adjusted $R^2 = 0.429$), indicating that ESG performance and firm-level characteristics account for a meaningful portion of the variation in shareholder returns. Overall, these findings provide consistent evidence that ESG performance is positively associated with firm performance, as reflected in profitability, reinforcing the view that sustainability initiatives can enhance financial outcomes when effectively implemented.

Table 7. Regression Analysis Results of BODSIZE and Profitability in Family Business (Hypothesis 2)

DV:	ROE
	Model 2
IV:	
BODSIZE	-2.356 (-0.839)
CVs:	
SG	51.952* (2.172)
FCF	8.198 (1.353)
LEV	-66.746* (-2.360)
SIZE	-0.472 (-0.141)
Constant	93.060 (0.982)
Observations	205
Adjusted R-squared	0.373
Year Fixed Effect	YES
Industry Fixed Effect	YES
Cluster by Industry	YES

Note: Table 7 presents the baseline regression results for Board Size on firm performance, measured by Return on Equity (ROE), which reflects firms' profitability. Board size is measured as the total number of directors serving on the Board of Directors at the end of each fiscal year. The results indicate that board size does not have a statistically significant direct association with firm profitability. Control variables include sales growth (SG), free cash flow (FCF), leverage (LEV), and firm size (SIZE). Year and industry fixed effects are included to control for macroeconomic conditions and sector-specific characteristics. Standard errors are clustered by industry. The * denotes statistical significance at the 10% level.

Table 7 presents the regression results examining the direct effect of board size on firm profitability. The coefficient on board size (BODSIZE) is negative but statistically insignificant ($\beta = -2.356$, $t = -0.839$), indicating that board size does not have a significant direct effect on return on equity (ROE). This finding suggests that merely increasing or decreasing the number of directors does not necessarily improve the financial performance of Indonesian family firms. Rather, board size alone may be insufficient to explain profitability, as the effectiveness of corporate governance depends on how boards function rather than simply their composition. Among the control variables, sales growth (SG) is positively associated with profitability, whereas leverage (LEV) exhibits a significant negative relationship with ROE. Free cash flow (FCF) and firm size (SIZE) do not show statistically significant effects. The model explains 37.3% of the variation in profitability after controlling for industry and year fixed effects.

The relationship between ESG and profitability was examined to see whether it varies with board size (See Table 8). To test this moderating effect, Eq. (1) is re-estimated using two subsamples: firms with larger boards (Model 1, Eq. 3) and those with smaller boards (Model 2, Eq. 4), classified according to the sample median (Board Size = 6). Firms above the median are defined as large-board firms, while those below are categorised as small-board firms. This split allows us to assess how differences in governance structure, particularly coordination efficiency and decision-making complexity, shape the translation of ESG performance into profitability. Both models incorporate firm-level controls, industry, and year fixed effects to address unobserved heterogeneity. Standard errors are clustered by industry to account for within-industry correlation.

For firms with a small board size (Model 2), the coefficient on ESG is positive and highly significant ($\beta = 0.219$, $t = 4.521$), indicating that ESG performance is strongly associated with higher shareholder returns. This suggests that in firms with smaller and more cohesive boards, ESG initiatives are more effectively translated into financial outcomes. Smaller boards may facilitate faster decision-making, clearer accountability, and stronger alignment of strategic priorities, enabling ESG to function as a value-enhancing capability. In contrast, for firms with a large board size (Model 1), the ESG coefficient remains positive but becomes statistically insignificant ($\beta = 0.382$, $t = 1.226$). This indicates that, although ESG might still be beneficial, its impact on firm performance is less consistent in firms with larger boards. Larger boards might introduce coordination challenges, dilute accountability, and slow decision-making, thereby limiting the effective implementation of ESG initiatives.

Table 8. The Moderating Role of Board Size on the Relationship between ESG and Profitability in Family Business (Hypothesis 3)

DV:	ROE	
	Large Board Size Model 3	Small Board Size Model 4
IV:		
ESG	0.382 (1.226)	0.219*** (4.521)
CVs:		
SG	66.283 (1.226)	32.032** (2.401)
FCF	-19.654 (-1.568)	20.384 *** (4.028)
LEV	-110.777* (-1.986)	-15.555 (-1.178)
SIZE	-2.259 (-1.303)	-6.269 (-1.820)
Constant	111.835 (1.672)	235.074* (1.934)
Observations	75	130
Adjusted R-squared	0.409	0.569
Year Fixed Effect	YES	YES
Industry Fixed Effect	YES	YES
Cluster by Industry	YES	YES

Note: Table 8 presents the regression results for the moderating effect of board size on the relationship between ESG and ROE. A positive and significant coefficient on ROE indicates that higher ESG performance is associated with higher returns on equity in family business firms with smaller board size. The model includes year and industry fixed effects to control for macroeconomic shocks and sector-specific characteristics. Standard errors are clustered by industry. The ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively.

The results in Table 9 examine the relationship between ESG performance and firm performance, proxied by profitability using both Return on Equity (ROE) and Return on Assets (ROA). Across both specifications, ESG performance is positive and statistically significant, indicating that firms with higher ESG scores tend to exhibit stronger financial performance. Specifically, the coefficient on ESG is positive and significant for ROE ($\beta = 0.222$, $t = 2.658$) and even stronger for ROA ($\beta = 0.147$, $t = 4.354$), suggesting that ESG contributes to profitability in both shareholder returns and operational efficiency.

Table 9. The Robustness Test on the Relationship between ESG and Profitability in Family Business

DV:	PROFITABILITY	
	ROE	ROA
IV:	0.222** (2.658)	0.147*** (4.354)
ESG		
CVs:	46.194* (2.215)	13.269** (2.831)
SG	13.261** (2.739)	12.960** (2.598)
FCF	-57.601* (-2.040)	-24.803*** (-6.938)
LEV	-3.190 (-1.803)	-2.475* (-2.081)
SIZE		
Constant	132.753* (2.138)	93.604** (2.390)
Observations	205	205
Adjusted R-squared	0.429	0.593
Year Fixed Effect	YES	YES
Industry Fixed Effect	YES	YES
Cluster by Industry	YES	YES

Note: Table 9 presents the robustness regression results on the relationship between ESG and profitability. Return on Equity (ROE) and Return on Assets (ROA) are used to measure profitability. The results show that ESG performance exhibits a strong, highly significant positive association with both profitability variables. The model includes year and industry fixed effects to control for macroeconomic shocks and sector-specific characteristics. Standard errors are clustered by industry. The ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively.

The stronger statistical significance observed in the ROA model indicated that ESG might have a more consistent effect on firms' ability to utilise their assets efficiently. This suggests that ESG enhances firm performance primarily through improvements in operational processes, resource allocation, and stakeholder engagement, rather than solely through financial leverage or equity-based returns. In contrast, while the positive effect on ROE confirms that ESG also contributes to shareholder value, the relatively lower statistical strength suggests that this channel may be more sensitive to financial structure and market conditions. The models demonstrate moderate to strong explanatory power, with the ROA model showing a higher adjusted R² (0.593) compared to the ROE model (0.429). This further supports the interpretation that ESG performance is more strongly linked to operational efficiency than to shareholder returns.

Table 10. The Effect of COVID-19 on the Relationship between ESG and Profitability in Family Business

DV:	ROE	
	Before COVID-19	After COVID-19
IV:	0.383* (2.278)	0.128 (1.366)
ESG		
CVs:	33.361 (1.338)	42.363** (2.580)
SG	20.216*** (3.658)	19.991 (1.802)
FCF	-87.386* (-2.060)	-17.872 (-1.257)
LEV	0.543 (0.109)	-3.460 (-1.733)
SIZE		
Constant	27.587 (0.187)	120.098* (2.041)
Observations	117	88
Adjusted R-squared	0.438	0.617
Year Fixed Effect	YES	YES
Industry Fixed Effect	YES	YES
Cluster by Industry	YES	YES

Note: Table 10 presents the additional analysis comparing the relationship between ESG performance and firm performance before (2011–2019) and after (2020–2023) the COVID-19 pandemic. Firm performance is measured by return on equity (ROE), and ESG performance is measured using the Refinitiv ESG Score (0–100). The results indicate that ESG performance is positively associated with profitability before the COVID-19 pandemic, whereas the relationship becomes statistically insignificant during the post-COVID period. Control variables include sales growth (SG), free cash flow (FCF), leverage (LEV), and firm size (SIZE). All models include year and industry fixed effects, and standard errors are clustered by industry. The ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

Table 10 presents the results of the subsample analysis comparing the relationship between ESG performance and firm profitability before (2011–2019) and after (2020–2023) the COVID-19 pandemic. The findings reveal that ESG performance is positively and significantly associated with return on equity (ROE) during the pre-COVID period ($\beta = 0.383$, $t = 2.278$, $p < 0.05$), supporting the view that sustainability initiatives contributed to superior financial performance under relatively stable economic conditions. However, the ESG coefficient becomes statistically insignificant during the post-COVID period ($\beta = 0.128$, $t = 1.366$), suggesting that the direct financial benefits of ESG diminished following the pandemic.

One possible explanation is that the COVID-19 crisis fundamentally altered firms' operating environments. During the recovery period, many firms, including family firms, shifted their strategic priorities toward preserving liquidity, maintaining operational continuity, and managing short-term financial risks (Zhang et al., 2022; Xu et al., 2023). Consequently, the immediate financial returns from ESG investments may have been overshadowed by broader economic uncertainty and heightened resource constraints (Azizah & Haron, 2025). While ESG continued to represent an important strategic capability, its financial benefits may have become more difficult to realise in the short term. Overall, the results indicate that although ESG contributed to financial performance before COVID-19, its direct effect became less pronounced after the pandemic, underscoring the importance of accounting for macroeconomic shocks when evaluating the financial outcomes of corporate sustainability initiatives.

Table 11. Endogeneity Tests - Panel A: Univariate Comparison of Means Between Treatment and Control Groups Before and After Balancing – Entropy Balancing

Variable	High Intensity	Low Intensity	High Intensity	Low Intensity
	(Treated Group)	(Control Group)	(Treated Group)	(Control Group)
	Before Balancing		After Balancing	
SG	0.095	0.094	0.095	0.095
FCF	0.149	0.132	0.149	0.149
LEV	0.193	0.242	0.193	0.193
SIZE	31.54	31.11	31.54	31.54

Table 12. Endogeneity Tests - Panel B: Regression Estimate after Entropy Balancing

VARIABLES	ROE
	Entropy Balancing
ESG	0.195* (2.139)
SG	45.986* (2.270)
FCF	14.084** (3.138)
LEV	-66.078* (-2.054)
SIZE	-2.050 (-1.213)
_webal	-2.686 (-1.310)
Constant	102.496* (1.914)
Observations	205
Adjusted R-squared	0.435
Year Fixed Effect	YES
Industry Fixed Effect	YES
Cluster by Industry	YES

Tables 11, Panel A and B, report an endogeneity robustness test using entropy balancing, which is employed to reduce observable differences between firms with relatively high ESG intensity (treated group) and those with lower ESG intensity (control group). This approach strengthens causal inference

by reweighting the control group to make both groups comparable on key firm characteristics before estimating the relationship between ESG performance and these characteristics.

Table 11, Panel A, presents the comparison of means for the treatment and control groups before and after balancing. Before weighting, noticeable differences exist between the two groups. Firms with higher ESG intensity tend to have lower leverage (0.193 vs 0.242), slightly higher free cash flow (0.149 vs 0.132), and larger firm size (31.54 vs 31.11), indicating that firms adopting stronger ESG practices may systematically differ from lower ESG firms. After entropy balancing, these differences are effectively eliminated. The means of sales growth, free cash flow, leverage, and firm size have become nearly identical across the two groups. This suggests that the weighting procedure successfully creates a more comparable counterfactual sample, reducing concerns that the baseline ESG effect is driven by observable firm characteristics.

Table 11, Panel B reports the weighted regression results using Return on Equity (ROE) as the dependent variable. The coefficient on ESG remains positive and statistically significant ($\beta = 0.195$, $t = 2.139$), indicating that the positive relationship between ESG performance and profitability persists even after controlling for selection bias based on observable characteristics. This finding is important because it suggests that the baseline results are not merely driven by the tendency of larger, less leveraged, or more financially flexible firms to adopt ESG. Instead, ESG appears to exert an independent positive association with shareholder returns.

DISCUSSION

This study provides evidence that ESG performance contributes positively to the profitability of Indonesian family firms, but that this effect depends on governance structure. Overall, ESG is positively associated with both ROE ($\beta = 0.222$, $p < 0.05$) and ROA ($\beta = 0.147$, $p < 0.01$), indicating that stronger ESG performance is associated with both higher shareholder returns and more efficient asset utilisation. This finding is consistent with the broader ESG literature, in which approximately 90% of empirical studies report a non-negative relationship between ESG and corporate financial performance (Friede et al., 2015). It also complements recent family-business research, which shows that the relationship between family involvement and ESG outcomes remains heterogeneous and context-dependent (Waldau, 2024). The present study therefore extends previous research by demonstrating that ESG can generate financial benefits specifically within Indonesian family firms, where sustainability decisions are simultaneously influenced by economic objectives and family-related considerations.

From a theoretical perspective, the positive ESG–profitability relationship supports the Resource-Based View (RBV), which suggests that firm-specific capabilities can generate competitive advantage when they are effectively deployed (Mushangai, 2023). ESG may constitute such a capability by strengthening stakeholder relationships, reputation, risk management, and organisational processes. However, the results also suggest that ESG should not be interpreted simply as an expenditure or compliance activity. Rather, its financial contribution depends on how effectively firms integrate sustainability into their strategic and organisational routines. This interpretation is particularly relevant to family firms because resources alone are insufficient to create competitive advantage; they must be appropriately bundled and leveraged through organisational processes (Sirmon & Hitt, 2003). Thus, the findings extend the RBV by suggesting that ESG creates value when it is embedded within the firm's broader governance and strategic architecture.

In contrast, board size has no significant direct effect on profitability, suggesting that the number of directors alone does not determine financial performance. This finding is important because previous studies provide mixed arguments regarding board size. Larger boards might provide broader expertise, stakeholder representation, and access to external resources, and a meta-analysis of 80 studies finds that larger boards can enhance corporate social performance (Zubeltzu-Jaka et al., 2020).

More importantly, the moderating analysis reveals that board size determines the extent to which ESG translates into profitability. ESG is positive and highly significant among firms with smaller boards ($\beta = 0.219$, $p < 0.01$), whereas the relationship becomes statistically insignificant among firms with larger boards ($\beta = 0.382$, $p > 0.10$). This result suggests that smaller boards may facilitate faster

decision-making, clearer accountability, and more effective coordination, allowing ESG capabilities to be translated into financial outcomes more efficiently. This interpretation is consistent with Sirmon & Hitt (2003), who emphasise that competitive advantage in family firms depends not only on possessing resources but also on effective resource management. Importantly, this finding does not imply that larger boards are inherently inefficient. Rather, it suggests that board size represents a boundary condition for ESG value creation, with smaller boards appearing better suited to converting sustainability capabilities into profitability in the Indonesian family-firm context.

This finding also provides an important contribution to the existing literature. Previous studies have primarily examined whether ESG affects financial performance or whether board characteristics affect ESG adoption and corporate social performance. For example, the meta-analysis of Zubeltzu-Jaka et al. (2020) focuses on the effect of board size on corporate social performance rather than on the ability of ESG to generate financial returns. Our study connects these two streams by showing that governance structure affects the financial conversion of ESG, rather than necessarily affecting profitability directly. This distinction is particularly relevant for family firms because their governance structures are closely connected to family control, long-term orientation, and socioemotional objectives. Hence, the contribution of this study is not simply that “smaller boards are better,” but that governance efficiency determines whether ESG becomes a financially productive organisational capability.

Finally, the pre- and post-COVID analysis provides an additional contextual contribution. The positive ESG–ROE relationship is stronger before the pandemic ($\beta = 0.383$, $p < 0.10$) but becomes insignificant after 2020 ($\beta = 0.128$). This suggests that the financial benefits of ESG were not constant across economic conditions. During the pandemic and subsequent recovery, family firms may have prioritised liquidity, operational continuity and short-term resilience, reducing the immediate profitability effect of sustainability investments. This contextual finding reinforces the argument that ESG value creation is contingent on both governance structure and economic conditions. Taken together, the evidence moves the literature beyond the question of whether ESG improves financial performance toward the more important question of under what organisational conditions ESG generates financial value.

CONCLUSION

This study aims at examining whether ESG performance enhances the financial performance of Indonesian family firms, whether board size directly affects profitability, and whether board size moderates the ESG–performance relationship. Using 205 firm-year observations of family firms listed on the Indonesia Stock Exchange during 2011–2023, the results show that ESG performance is positively associated with both ROE and ROA. In contrast, board size has no significant direct effect on profitability. Importantly, the ESG–profitability relationship is significant among firms with smaller boards but not among those with larger boards, suggesting that board structure conditions the extent to which ESG investments are translated into financial value (Ab Aziz et al., 2024). Additional analysis indicates that the ESG–profitability relationship is evident before COVID-19 but becomes statistically insignificant in the post-2020 period.

These findings contribute to the literature by positioning governance structure as an important boundary condition in the ESG–financial performance relationship. From a Resource-Based View perspective, ESG can function as a strategic organisational capability, but its financial value depends on how effectively firms deploy and coordinate such resources. The findings also extend the family business literature by showing that board structure can shape the economic outcomes of ESG engagement. Although Socioemotional Wealth (SEW) provides an important theoretical lens for understanding family firms' non-financial priorities, it is not directly measured in this study and should therefore be interpreted as a conceptual explanation rather than an empirically tested mechanism.

The findings have practical implications for family business owners, investors, and policymakers. Rather than treating ESG primarily as a disclosure or compliance requirement, family firms should integrate ESG into strategic decision-making and ensure that governance structures support effective implementation. The absence of a direct board-size effect suggests that simply increasing the number

of directors is unlikely to improve profitability; instead, board cohesion and decision-making efficiency might be more important for converting ESG initiatives into financial outcomes. Investors may therefore benefit from assessing ESG performance together with governance characteristics when evaluating family firms.

This study has several limitations. First, the sample comprises 205 firm-year observations of Indonesian family firms. Due to the early stage of sustainability reporting in emerging markets, ESG data availability for Indonesian family firms in Refinitiv Eikon was relatively limited in the early years of the sample period (2011–2014). However, coverage expanded significantly following the implementation of OJK Regulation No. 51/POJK.03/2017 and subsequent sustainability reporting mandates, which drove a marked increase in ESG disclosure after 2017. While mitigating potential selection and large-cap biases using entropy balancing and fixed-effects estimations, future research could expand upon this by incorporating broader datasets or alternative ESG databases as sustainability reporting matures in emerging economies. Second, while this study applies Socioemotional Wealth (SEW) as a theoretical perspective to interpret family firm behaviour, we do not directly measure SEW using empirical metrics. Future research could build upon our findings by directly quantifying SEW using validated instruments, such as the FIRE scale (Naldi et al., 2024), to capture its multi-dimensional impact on sustainability and financial performance.

Future research could investigate additional governance characteristics beyond board size to better understand how governance quality shapes the effectiveness of ESG strategies. Comparative studies across countries and institutional settings would help determine whether the governance mechanisms identified in this study are specific to Indonesia or generalisable to other emerging economies. Finally, qualitative and mixed-method approaches could provide deeper insights into how family firms integrate ESG considerations into strategic decision-making and board processes, particularly during periods of economic uncertainty.

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AI Disclosure

ChatGPT was used solely for brainstorming and exploring possible interpretations of the findings. AI was not used for data analysis, statistical calculations, generation of empirical results, or determination of the study's conclusions. All analyses, calculations, interpretations, and final academic judgments were conducted and verified by the authors, who take full responsibility for the content and conclusions of this study.