Volume 18, Number 1, 2026, pp 68 – 85, Jurnal Akuntansi, Program Studi Akuntansi, Fakultas Hukum dan Bisnis Digital, Universitas Kristen Maranatha. ISSN 2085-8698 | e-ISSN 2598-4977. http://journal.maranatha.edu

The Role of Financial Constraints in The ESG Performance and Financial Performance Relationship

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Received 14 February 2026; Revised 09 April 2026; Accepted 20 April 2026

Abstract

Purpose – This study is to determine the influence of ESG performance on a financial performance, considering financial constraints encountered by the company.
Design/Methodology/Approach – Using a sample of businesses listed on the Indonesian Stock Exchange between 2017 and 2023, regression with moderate regression analysis is the methodology employed.
Findings – The results of the study prove that a company's ESG performance can increase its profitability and that financial constraints do not influence or moderate the effect of ESG performance on financial performance.
Research limitations/Implications – The Financial Services Authority (OJK) and the IDX can evaluate whether the sustainability reporting mandate places an

additional burden on financially constrained companies or whether it can actually help companies gain access to green financing. The results of this study can be used as a preliminary reference in formulating a more targeted incentive scheme for companies committed to ESG, especially for companies with financial constraints.

Keywords: ESG Performance, Financial Constraint, Financial Performance, Indonesia, Sustainability

Introduction

The current global business paradigm has undergone a fundamental transformation from a pure profit orientation to the creation of long-term value that is inclusive for all stakeholders. In Indonesia, the urgency of implementing Environmental, Social, and Governance (ESG) principles is growing in line with increasing awareness of the climate crisis, social inequality, and demands for transparent governance. The Indonesia Stock Exchange (IDX) has responded to this trend by launching indices such as the IDX ESG Leaders to encourage issuers to integrate sustainability into their operational strategies, which is reinforced by regulation through POJK No. 51/POJK.03/2017 on the Implementation of Sustainable Finance. Although financial performance remains a primary concern for companies as it serves as a going concern signal to attract investors (Schoenmaker et al., 2023; Spindler, 2022) and a means of maintaining good relationships with stakeholders to maximize performance (Choi & Wang, 2009), the adoption of Sustainable Development Goals (SDGs) in business operations presents significant new challenges. The pressure to maintain cross-generational sustainability forces companies to change the direction of their business, but on the other hand, the implementation of the SDGs has the potential to increase operational costs in the short term, which can erode profitability (Hansen & Xie, 2025). As a result, the effectiveness of ESG investments in improving the financial performance of companies in emerging markets such as Indonesia remains a complex empirical debate between ethical demands and financial realities.

Theoretically, investing in environmental, social, and governance aspects is believed to improve financial performance through operational efficiency, reduced litigation risk, and strengthened corporate reputation. However, its implementation requires massive resource allocation and often does not provide immediate short-term benefits. This phenomenon has sparked a discourse on whether the costs of ESG initiatives are productive investments or simply cost burdens that erode profitability, especially for companies with vulnerable capital

structures amid post-pandemic economic fluctuations and geopolitical uncertainty. Based on pecking order theory, companies tend to rely on internal funding sources to maintain cash flow and minimize adverse selection and information asymmetry (Hsu et al., 2013; Marimuthu & Singh, 2021; Ni & Yu, 2008), so that disruptions to financial sources will trigger financial constraints that hamper the company's ability to innovate, invest, and operate optimally (Chang et al., 2019; Phan, 2025). This challenge is even more crucial considering that the adoption of sustainability strategies, such as the transition to renewable energy, requires substantial upfront costs for organizations (Prokopenko et al., 2023), even though these expenditures have the potential to generate long-term financial returns through reduced energy costs and improved profitability metrics. Therefore, companies in Indonesia are currently faced with a strategic dilemma of remaining financially competitive while meeting increasingly stringent ethical standards from global investors amid limited available resources.

Financial constraints emerge as a crucial factor that determines the extent to which companies are able to execute their ESG agenda without sacrificing their financial stability. Companies facing high financial constraints tend to have limited access to external funding and high capital costs, so that any allocation of funds for non-core projects such as ESG will be evaluated more rigidly. In Indonesia, the characteristics of companies dominated by concentrated ownership and dependence on bank financing make the dynamics of financial constraints highly relevant in moderating the impact of strategic policies on financial performance (Y. Li et al., 2018). The existence of financial constraints can be an obstacle that weakens the positive transmission from ESG performance to financial performance (Ariff et al., 2024), or conversely, encourage companies to use ESG as a signal to gain easier access to funding (Eliwa et al., 2021). Research by Zhou et al. (2022) proves that corporate financial constraints can hinder investment in ESG projects.

In developing countries, companies need stable finances to be able to implement Environmental, Social, and Governance (ESG) policies. According to Prokopenko et al. (2023), investing in ESG projects requires greater additional financial resources, especially during times of inflation (Wulandari et al., 2025). Companies in developing countries often have limited access to government sustainability incentives or green financing, so they must allocate more internal funds to meet ESG criteria (Cherkasova & Nenuzhenko, 2022). Especially for businesses that do not have a strong sustainability plan, these higher costs can burden cash flow and reduce company profits (Chang et al., 2019; Ghosh & Dutta, 2021). Often, businesses must balance the demands of maintaining short-term profitability and compliance with sustainability principles. Several empirical studies reveal that ESG can have a positive impact on financial performance.

Research by Cherian & Seranmadevi (2024) has proven that companies that implement ESG will achieve better financial performance. Conversely, research by Hansen & Xie (2025) and Risal et al. (2024) shows that it can actually have a negative impact on financial performance.

Industrial sectors in Indonesia have varying degrees of sensitivity to environmental and social issues; for example, the energy and mining sectors face higher regulatory pressure than the technology sector. However, financial constraints are cross-sectoral and influence the investment decisions of all types of companies. By sampling various sectors on the IDX, this study aims to examine whether the moderating effect of financial constraints is universal or specific to certain financial conditions. This is important to validate whether ESG is truly an instrument that guarantees the future of a company or can only be enjoyed by companies that are already financially established.

This study uses stakeholder theory to explain the phenomenon of financial constraints as a barrier to the effectiveness of sustainability strategies. While previous studies have focused on moderating variables such as company size (Joshi & Joshi, 2024) or innovation (X. Li & You, 2025), the use of a financial constraint index offers a more incisive analysis of a company's internal capacity to support its ESG agenda. This study is expected to contribute new theoretical insights to the literature on financial management and sustainability accounting, particularly regarding how financial constraints affect the implementation of business ethics in developing countries.

The impact of this research is not limited to the advancement of science, but also has practical implications for policymakers. The Financial Services Authority (OJK) and the Indonesia Stock Exchange (IDX) need empirical data to evaluate whether the sustainability reporting mandate places an additional burden on financially constrained companies or actually helps them gain access to green financing. The results of this study will serve as an important reference in formulating more targeted incentive schemes for companies that are committed to ESG but have financial constraints.

Strategically, for company managers, the results of this study will serve as a guide in managing ESG investment portfolios. Managers need to know the optimal point at which ESG investments begin to yield positive returns and how mitigation should be carried out when companies face liquidity constraints. Without an understanding of the moderating role of financial constraints, companies risk being caught up in greenwashing practices simply to cover up poor financial performance or, conversely, losing competitive opportunities by being too conservative in investing in social and environmental issues.

This study is a comprehensive effort to map the relationship between business ethics and financial performance within the framework of limited economic realities. By focusing on issuers on the IDX, this study will enrich the literature on sustainable finance in Indonesia. Through a

rigorous quantitative approach and the use of financial constraint moderation, it is hoped that answers can be found to the question: does ESG provide benefits for Indonesian companies, especially when they are under financial pressure?

Literature Review & Hypothesis

Literature Review

Stakeholder Theory

Stakeholder theory was first proposed by Freeman, R. (1984), explaining that every group or individual can be influence or influence the objectives of an organization (Littau et al., 2010). This theory explains that companies are not entities that operate solely for their own interests, but also benefit all stakeholders, both internal, such as employees, owners, or management, and external, such as customers, suppliers, the government, the community, and the environment (Freeman et al., 2004).

ESG Performance

From an accounting research perspective, the link between stakeholder theory and ESG performance lies in the position of ESG as an operational manifestation of corporate responsibility towards all its stakeholders. The sustainability of a company depends on its ability to balance various interests, where ESG performance serves as a tangible measurement instrument for meeting these expectations, such as environmental protection, social contribution, and transparent corporate governance (Alsayegh et al., 2020; Birindelli et al., 2018). By optimizing ESG performance, companies are strategically managing relationships with stakeholders to reduce risk, build moral legitimacy (Grisales & Aguilera-Caracuel, 2019; Zhou et al., 2022), and reduce information asymmetry (Aboud & Diab, 2018). Ultimately, ESG performance will enhance reputation and create sustainable long-term corporate value beyond mere financial gains for shareholders (Pardamean & Gunawan, 2025; Putri & Difa, 2024).

The sustainability of a company is highly dependent on its ability to balance various interests, where ESG performance serves as a tool to integrate and respond to these needs. A study found that companies that invest in ESG factors show better long-term performance compared to those that focus solely on short-term financial gains (Garcia & Orsato, 2020). Therefore, strategic management efforts through ESG performance contribute significantly to the creation of sustainable value, which goes beyond mere financial gains for shareholders (T. Li et al., 2021).

Financial Constraint

Financial constraints are conditions faced by companies when they encounter financial difficulties in funding their operational activities and investment projects due to a significant cost gap between internal and external funding (Hidayat, 2010; Srivastava et al., 2019). This phenomenon generally arises due to information asymmetry and conflicts of interest that cause capital markets to impose high risk

premiums or credit restrictions (Hidayat, 2010; Salehi et al., 2019). As a result, financial constraints force companies to relinquish positive investment opportunities, ultimately hampering growth, innovation, and the overall economic performance of the company.

Financial Performance

Financial performance is an indicator of a company's success in managing its economic resources to generate profitability that reflects the operational effectiveness and financial health of the entity during a certain period (Alareeni & Hamdan, 2020). This performance is often measured using return on assets (ROA) and return on equity (ROE) proxies, where ROA is used to evaluate profit efficiency regardless of the source of funding. ROE represents a company's ability to optimize the capital contributed by shareholders to create added value and a rate of return on investment for the company's owners.

Previous Study and Hypothesis

Within the framework of Stakeholder Theory, the sustainability and financial success of a company depends on its ability to manage relationships with all stakeholders, not just shareholders. High ESG performance reflects the fulfillment of expectations regarding environmental, social, and transparent governance aspects (Buallay, 2019). When companies invest in ESG, they build strong social capital and reputation in the eyes of consumers, with the aim of increasing loyalty, employees by increasing productivity, and regulators by minimizing the risk of fines. Harmonious relationships with these stakeholders create operational efficiency and sustainable competitive advantage, which will be directly reflected in increased profitability.

Empirical support for this positive relationship is found in the majority of global and domestic studies. Research by Buallay (2019) found that ESG investment correlates positively with corporate profitability. In the Indonesian context, research results show that ESG disclosure sends a positive signal to investors on the Indonesia Stock Exchange, which reduces risk perception and cost of capital. Companies with good ESG scores tend to have broader market access and stronger resilience to external shocks, which ultimately boosts financial performance (Alareeni & Hamdan, 2020). Companies with good ESG performance tend to have higher ROA, indicating that sustainability and social responsibility can contribute positively to a company's operational efficiency (Kim & Li, 2021; Sandberg et al., 2022). In other words, investing in environmental, social, and governance aspects can improve resource efficiency.

Based on this argument, it can be concluded that ESG practices are not a cost burden, but rather a strategic investment that can create added value. By meeting the interests of stakeholders, companies can mitigate risks while capturing new market opportunities. Therefore, it is predicted that the higher the ESG performance achieved by a company,

the better its financial performance will be.
H1: ESG performance has a positive impact on financial performance.

Stakeholder Theory emphasizes the importance of meeting the expectations of all parties through ESG, the implementation of which requires significant financial resources (slack resources) (Maqbool & Hurrah, 2020). When companies experience financial constraints, there is internal competition in the allocation of funds between core operations and sustainability initiatives. In conditions of tight liquidity, massive ESG investments can be perceived by stakeholders as inefficient or even disruptive to the company's stability (García & Vargas, 2024). When companies are faced with tight liquidity, ESG investments are viewed by stakeholders as a threat to the company's stability. Tommaso & Thornton (2020) note that although ESG has long-term potential benefits, stakeholders view these ESG investments as a waste of company resources when facing financial challenges.

Several studies show that the role of available resources is crucial in determining the effectiveness of a company's strategy. Research by Zhao et al. (2018) reveals that companies facing financial constraints tend to have limitations in carrying out social and environmental responsibility activities. In emerging markets such as Indonesia, financially constrained companies are often forced to prioritize short-term survival over long-term ESG investments. A study by Nollet et al. (2016) states that the existence of financial constraints acts as an inhibitor that weakens the positive correlation between ESG scores and profitability, as the market tends to doubt the sustainability of ESG investments in companies with cash flow problems.

It can be concluded that the effectiveness of ESG performance in boosting financial performance is highly dependent on the financial health of the company. Financial constraints function as a moderating variable that weakens the effect (Ruan & Liu, 2021). This means that the positive effect of ESG performance on financial performance will be weaker or insignificant when a company is experiencing high financial constraints compared to companies that have loose financial flexibility.
H2: Financial constraints moderate the effect of ESG performance on financial performance.

Based on the differences in previous research results, this study focuses on ESG investment mechanisms under financial constraints. Specifically, it examines the relationship between ESG performance and corporate financial performance, considering financial constraints as factors that can weaken or strengthen this relationship. This study uses a sample of companies indexed on the Indonesian stock exchange. Taking into account previous phenomena, theories, and research, this study aims to determine whether financial constraints have a significant effect on corporate financial performance in ESG

implementation. The research model is as follows:

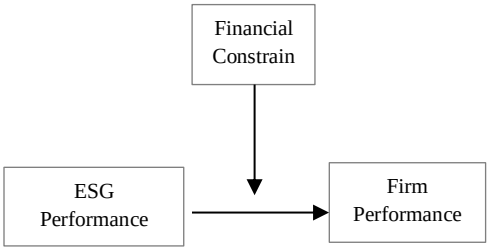

Figure 1
Conceptual Framework
Source: Author (2026)

Research Method

Data Description

ESG data is obtained from the Bloomberg index, while ROA and ROE are obtained from OSIRIS. The WW index is applied and calculated based on the measurement process (Whited & Wu, 2006) to measure the severity of financial constraints. The WW index is a comprehensive value of six variables: cash flow, company size, leverage, industry sales growth, company sales growth, and dividend payer dummy (Hadlock & Pierce, 2010). Companies with a higher WW index have greater financial constraints than companies with a lower index.

The control variable in this study uses profit margin, which was selected based on the company's ability to generate profits to maintain its finances. The use of one control variable is considered appropriate by the researcher because, according to (Whited & Wu, 2006), more control variables are not always better as they can cause bias in a well-specified model.

Methods

Data Analysis Technique

The main method used is Moderated Regression Analysis (MRA), with samples from 2017-2023 of companies indexed on the Indonesia Stock Exchange. The research model was tested with XTGLS, and the research model used robustness to ensure the research model with robustness tests.
The MRA regression equation formula in this study is as follows:

$$FP = \alpha + \beta_1 ESG_{it} + \beta_2 FC_{it} + \beta_3 LEV_{it} + \beta_4 SIZE_{it} + \varepsilon$$

$$FP = \alpha + \beta_1 ESG_{it} + \beta_2 FC_{it} + \beta_3 LEV_{it} + \beta_4 SIZE_{it} + \beta_5 (ESG_{it} * \beta_6 FC_{it}) + \varepsilon$$

Notes:
FP : Financial Performance
α : Constant
β1-β5 : Regression Coefficients
ESG : ESG Performance
FC : Financial Constraints
Lev : Leverage
Size : Size
ESG*FC: Moderated of Financial Constraints
i : Cross-sectional unit
t : Time period
ε : Error term

Operational Definition of Variable

The operational definitions of measurements in this study are as follows: ESG performance is a ratio

value obtained from the Bloomberg index calculation, ROA is the result of net income divided by total assets, and ROE is the result of net income divided by shareholders' equity.

Financial Performance
The company's ability to generate financial growth. The indicator by return on assets and return on equity. The formula is:

ROA =
Net Profit/Total Assets x 100%

ROE = Net Profit ÷ Shareholders' Equity (or Total Equity) × 100%

(Yulandari et al., 2019).

ESG Performance
ESG disclosure in a firm is a combined total score from environmental, social and governance. The score used in this research is the ESG Combined Score that has been published on Bloomberg. Bloomberg ESG score has not been widely used in earlier studies. However, the credibility of the score cannot be questioned as a number of studies have used Bloomberg's ESG score (Giannarakis et al., 2014).

Financial Constraint
The level of financial constraints faced by companies. In this study, the WW Index is applied and calculated based on the measurement process of Whited and Wu (2006) to measure the severity of financial constraints.

The WW Index is a comprehensive score of six variables: cash flow, company size, leverage, industry sales growth, company sales growth, and a dividend payer dummy (Hadlock & Pierce, 2010). Companies with a higher WW Index have greater financial constraints compared to companies with a lower index.

Leverage
Leverage is how the company's ability to manage debt. The formula is:
Total Debt/Total Assets
(Guo et al., 2021).

Size
The size of a company, whether large or small, is determined by its total assets. The formula is LogN Total Assets (Landi & Sciarelli, 2019).

Results and Discussion

Descriptive Statistics
Based on research data from 700 observations, descriptive statistics show that the financial and non-financial profiles of the sample companies are quite diverse. The financial performance variable, proxied by ROA, has an average (mean) value of 0.083 (8.3%), indicating that, in general, the sample companies are able to generate a net profit of 8.3% of their total assets.

Table 1
Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	700	0.083	0.111	-0.388	0.747
ROE	700	0.15159	0.33246	-2.341	2.8214
ESG	700	0.414	0.118	0.165	0.758
PM	700	0.119	0.186	-0.827	0.938
LEV	700	0.492	0.26	0.03	2.471
Size	692	14.192	1.192	10.767	17.18
FC	700	0.27	0.444	0	1

Source: Stata Output Results (2026)

However, there is considerable volatility with a standard deviation of 0.111 and a wide range of values between -0.388 and 0.747, reflecting significant differences in managerial efficiency between companies. Meanwhile, the ROE variable shows an average of 0.15159 with a very wide data distribution (Min. -2,341; Max. 2,8214), which indicates extreme variations in equity returns for shareholders or the potential influence of outliers on the capital structure of the sample companies.

In terms of non-financial aspects, the companies' ESG performance had an average score of 0.414 (41.4%) with a relatively moderate level of dispersion (Std. Dev 0.118). This indicates that the disclosure or performance of the sample companies in terms of environmental, social, and governance was at a moderate level, with the highest score reaching 0.758. In terms of capital structure, the average leverage (LEV) is 0.492, which means that on average, companies finance 49.2% of their assets through debt, with some companies having very aggressive debt levels that exceed their total assets (Max. 2.471). The Size variable, proxied by the logarithm of total assets, shows an average of 14.192 with low dispersion (1.192), indicating that the size of companies in the sample tends to be homogeneous. Finally, the Financial Constraint (FC) variable, which is a dummy variable, shows an average value of 0.27, meaning that around 27% of the total observations in the sample were identified as experiencing financial constraints.

Table 2
Pairwise Correlations

Variable	(1)	(2)	(3)	(4)	(5)	(6)
(1) ROA	1.000					
(2) ROE	0.7730	1.000				
(3) ESG	0.1124	0.0554	1.000			
(4) LEV	-0.2827	-0.1737	0.0054	1.000		
(5) Size	-0.0254	0.0430	0.3418	0.1810	1.000	
(6) FC	-0.0096	-0.0075	0.0427	0.0502	-0.0464	1.000

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

Sourced: Processed Data using Stata17 (2026)

Based on the correlation values between the independent variables ESG, Size, LEV, and FC, all of which are below 0.80, it can be concluded that there is no indication of serious multicollinearity in this research model, so these variables are suitable for use in further regression testing.

Table 3 shows the main results that the influence of ESG is significant on f inancial performance and the moderation of financial constraints is not significant.

In the table 4, show robustness test, the result showed that ESG has a positive significant to financial performance.

Regression Test Result

Table 3
Regression Test Results

	ROA			ROE			ROA_ (Dummy Years)		
	ROA	ROA	ROA	ROE	ROE	ROE	ROA	ROA	ROA
Intercept	0.039***	0.117**	0.116**	285.066***	222.417***	221.616***	0.052***	0.128**	0.127**
	(2.589)	(2.400)	(2.394)	(11.173)	(2.664)	(2.671)	(2.905)	(2.515)	(2.514)
ESG	0.106***	0.113***	0.112***	86.764	56.865	54.490	0.122***	0.130***	0.128***
	(2.988)	(3.086)	(2.974)	(1.465)	(0.905)	(0.843)	(3.335)	(3.356)	(3.233)
FC		-0.000			-0.008			-0.000	
		(-0.143)			(-0.025)			(-0.070)	
LEV		-0.118***	-0.118***		-127.138***	-127.385***		-0.118***	-0.119***
		(-7.445)	(-7.463)		(-4.685)	(-4.697)		(-7.514)	(-7.531)
Size		-0.002	-0.001		9.764	9.831		-0.001	-0.001
		(-0.419)	(-0.404)		(1.546)	(1.558)		(-0.396)	(-0.382)
ESG*FC			0.000			0.108			0.000
			(0.071)			(0.146)			(0.151)
T2018							-0.012	-0.012	-0.012
							(-0.666)	(-0.689)	(-0.691)
T2019							-0.020	-0.018	-0.018
							(-1.142)	(-1.075)	(-1.065)
T2020							-0.057***	-0.054***	-0.054***
							(-3.214)	(-3.172)	(-3.174)
T2021							-0.015	-0.015	-0.015
							(-0.958)	(-0.953)	(-0.952)
T2022							0.000	0.001	0.001
							(0.018)	(0.086)	(0.087)
T2023							-0.035**	-0.036**	-0.036**

	ROA			ROE			ROA_ (Dummy Years)		
							(-2.141)	(-2.299)	(-2.300)
N	**700**	**692**	**692**	**700**	**692**	**692**	**700**	**692**	**692**
Adj.R^2	0.01	0.09	0.09	0.00	0.03	0.03	0.03	0.10	0.10
F-Stat	8.929	17.239	17.234	2.146	6.202	6.208	4.002	9.034	9.036

t statistics in parentheses
* p<0.10, ** p<0.05, *** p<0.01
Sourced: Processed Data using Stata17 (2026)

Table 4
Robust Test

		Robust		
	Coefficient	**std. err.**	**z**	**P-Value**
ROA				
L1.	0.318906	0.1068477	2.98	0.003
ESG	-0.014098	0.0753442	-0.19	0.852
LEV	-0.2222914	0.1058708	-2.10	0.036
Size	0.0368646	0.038918	0.95	0.344
FC	0.0002661	0.0001425	1.87	0.062

Source: Data Processed (2026)

Analysis

The Influence of ESG Performance and Financial Performance

The statistical test results for ESG performance against financial performance obtained a coefficient value of 0.112 with a positive and significant direction. For moderation, a coefficient value of 0.000 was obtained with a positive and insignificant direction. Leverage showed a coefficient value of -0.118 with a negative and significant direction, and company size showed a coefficient value of -0.001 with a negative and significant direction.

The results of the study show evidence that ESG performance has a positive and significant effect on a company's financial performance. These results prove that companies with positive ESG performance will have an impact on the company, because ESG performance can improve sustainability by reducing agency costs (Lun et al., 2025; Zhang et al., 2025) and mitigating company risks (Chen et al., 2024; Ding et al., 2025; Florio et al., 2025). Meanwhile, financial constraints not significant the influence of ESG performance on financial performance. This means hypothesis 2 (two) is rejected. These findings are consistent with the pecking order theory, which emphasizes that companies are committed to ESG but still pay attention to the company's cash flow. Companies with positive ESG performance will have a high chance of gaining investor support, thereby enhancing their reputation and ensuring the company's long-term sustainability (Grishunin et al., 2022; Ortas et al., 2015). This occurs because the implementation of ESG by companies will provide added

value through the company's efforts to reduce agency costs, improve operational efficiency, and enhance the company's ability to mitigate risks arising from climate change that threaten the business.

These results also reinforce previous literature that confirms a positive relationship between ESG and financial performance. Studies have found that effective ESG can reduce a company's cost of capital (Hazaea et al., 2025), while Grishunin et al. (2022) report that ESG practices improve market performance by strengthening investor confidence. Robust ROE is also supported by research from Aziz et al. (2023), whose results prove that ESG disclosure provides positive evidence with an increase in ROE. Thus, this study supports the view that ESG is not only a social responsibility instrument, but also a business strategy capable of creating financial value.

The Moderating Effect of Financial Constraints

The statistical test results for financial constraints moderation show a coefficient value of 0.000 and are not significant. These results indicate that financial constraints do not appear to play a moderating role in the relationship between ESG performance and company financial performance. Empirically, these findings show that the strength or weakness of financial constraints faced by companies does not change, strengthen, or weaken the contribution of environmental, social, and governance practices in influencing company profitability. It can be said that the influence of ESG performance on financial performance is constant and does not depend on the liquidity conditions or funding constraints experienced by entities.

From a stakeholder theory perspective, the results of this study imply that the strategic benefits gained from meeting stakeholder expectations through ESG performance are independent of a company's internal financial conditions. Although this theory often assumes that the allocation of resources for ESG activities requires financial flexibility, this insignificant moderation indicates that the value of trust and legitimacy built through ESG continues to have a stable impact on financial performance without being disrupted by financial constraints. As proven by the research of Wesseh et al (2025), ESG performance remains significant in improving financial performance even if the company does not have financial flexibility. This means that stakeholders continue to appreciate the company's commitment to sustainability, regardless of whether the company is experiencing financial constraints or has abundant capital (Pasupuleti et al., 2024).

The results of this study support the argument that investment in ESG aspects has become a fundamental standard in modern business practices, the impact of which is no longer significantly influenced by short-term financial fluctuations. The findings are in line with several previous studies that also found that

the effectiveness of ESG in improving financial performance is driven more by reputation (Ryzhakova et al., 2022), reduction of systemic risk Tian-hao et al., (2025), and availability of operating cash flow (Lintang & Ardillah, 2021). These results confirm that ESG performance is a driver of profitability, whereby management can continue to integrate sustainability principles without having to worry that financial constraints will hinder the economic benefits of such practices.

Conclusion and Recommendation

Conclusion

This study aims to examine how financial constraints affect ESG performance on financial performance. Using the MRA method and a sample of companies with ESG scores on the Indonesia Stock Exchange, it was found that financial constraints do not affect or moderate the influence of ESG performance on financial performance. Limited funds cannot hinder companies in their ESG practices, as ESG can indeed provide significant benefits. Companies prioritize long-term sustainability and continue to invest in ESG even when facing financial constraints, as they recognize that ESG practices can deliver long-term benefits.

Recommendation

This study provides new theoretical contributions to the literature on financial management and sustainability accounting, particularly regarding how financial constraints affect the implementation of business ethics in developing countries such as Indonesia in ESG practices. The practical implications for policymakers such as the Financial Services Authority (OJK) and the Indonesia Stock Exchange (IDX) are that they can evaluate whether the sustainability reporting mandate places an additional burden on financially constrained companies or whether it can actually help companies gain access to green financing. The results of this study can be used as a preliminary reference in formulating more targeted incentive schemes for companies committed to ESG, especially for companies with financial constraints.

The implications for companies are that these results will serve as a guide in managing ESG investment portfolios. Managers need to know the optimal point at which ESG investments begin to yield positive returns and how mitigation should be carried out when companies face liquidity constraints. Without an understanding of the moderating role of financial constraints, companies risk being trapped in greenwashing practices merely to cover up poor financial performance or, conversely, losing competitive opportunities by being overly conservative in investing in social and environmental issues.

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