

Determinants of Firm Value Mediated by Profitability in Pharmaceutical Companies Listed on the Indonesia Stock Exchange

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Abstract: This study aims to examine the determinants of firm value with profitability as a mediating variable in pharmaceutical companies listed on the Indonesia Stock Exchange (IDX) during the 2018–2023 period. The study investigates the effect of sustainability report disclosure, institutional ownership, and enterprise risk management on firm value, with return on assets (ROA) as a mediating variable. A quantitative approach was applied using panel data regression and path analysis via EViews version 12. The findings reveal that the sustainability report, institutional ownership, enterprise risk management, and ROA all have a significant and positive impact on firm value. Furthermore, institutional ownership and enterprise risk management influence firm value through the mediation of financial performance. This study contributes to the theoretical literature by enhancing insights into the integration of sustainability practices, corporate governance, and financial performance in shaping firm value, particularly in the pharmaceutical sector.

Keywords: Sustainability Report, Institutional Ownership, Enterprise Risk Management, Financial Performance, Firm Value

1. Introduction

The pharmaceutical industry in Indonesia plays a strategically vital role in the national economy, particularly in providing high-quality medicines to support public health (Ministry of Health, 2022). In recent years, this sector has faced significant challenges, ranging from increasingly stringent regulations to disruptions caused by the COVID-19 pandemic (BPOM, 2021). In navigating these dynamics, pharmaceutical companies are required not only to focus on profitability but also to incorporate risk management, transparency, and sustainability into their operations. For instance, they are expected to disclose information on the social and environmental impacts of their activities through sustainability reports. This integration of financial and social performance, along with sustainable governance, is crucial for long-term corporate resilience.

Firm value is one of the key indicators used to assess a company's success, reflecting investors' perceptions of its future prospects and performance. As such, firm value is a critical consideration for stakeholders, including managers and investors, in evaluating a company's potential to deliver optimal returns. Factors such as sustainability report disclosures, institutional ownership, and the implementation of enterprise risk management (ERM) have become central topics in management research, as evidenced by growing empirical studies such as Budiana and Budiasih (2020), Rahmasari and Trisnaningsih (2021), and Solikhah and Hariyati (2019), which underscore their significant influence on firm performance and value across various industries. Previous studies have shown mixed results regarding these factors' impact on firm value. For example, Budiana and Budiasih (2020) found that enhanced sustainability disclosures improve investor trust and firm value, while Amin et al. (2023) argued that such disclosures do not always significantly influence firm value, particularly in the manufacturing sector.

Institutional ownership is another important variable often associated with firm value. Institutional investors, who typically hold substantial shares, are expected to play a role in strengthening managerial oversight and ensuring that management decisions align with shareholder interests. Research by Rahmasari and Trisnaningsih (2021) indicated that institutional ownership significantly impacts firm value through improved corporate governance.

However, their findings in the pharmaceutical sector also suggest that this relationship is not universally significant.

Moreover, effective implementation of Enterprise Risk Management (ERM) is believed to positively influence firm value by helping firms identify and manage risks that may affect overall performance. Solikhah and Hariyati (2019) demonstrated that good risk management systems reduce uncertainty and enhance financial stability. Nonetheless, studies such as Munawwaroh et al. (2021) highlight that the effectiveness of ERM can vary depending on its implementation approach.

In the context of pharmaceutical companies, high profitability often facilitates better risk management and improved financial performance. Return on Assets (ROA) is a key indicator used to measure how efficiently a firm generates profit from its assets. According to Pradita (2019), ROA significantly influences firm value, as investors tend to favor firms with high returns on investment, thereby boosting stock demand and price.

Based on this background, the present study aims to examine the effects of sustainability report disclosures, institutional ownership, and enterprise risk management on firm value, mediated by financial performance, in pharmaceutical companies listed on the Indonesia Stock Exchange (IDX) during the 2018–2023 period. The pharmaceutical sector presents a particularly relevant case due to its stringent regulatory environment, high social responsibility expectations, and critical role in public health. This research seeks to make a theoretical contribution by enriching the literature on the integration of sustainability practices, corporate governance, and financial performance in shaping firm value. It also provides practical insights for managers and investors in making investment decisions based on transparency and effective risk management.

2. Literature Review

Firm value reflects the market's perception of a company's performance and long-term prospects, often proxied by the Price to Book Value (PBV) ratio. This ratio illustrates the comparison between the market price per share and the book value per share. According to Modigliani and Miller (1958), under their capital structure theory, firm value is unaffected by capital structure in a perfect capital market. However, in practice, firms with well-managed capital structures and effective risk management systems can enhance corporate stability and improve investor perceptions, thereby increasing firm value.

Signaling Theory, as introduced by Spence (1973), argues that companies demonstrating transparency in their operations—such as through the disclosure of clear sustainability reports—send positive signals to the market. These disclosures build investor trust and can potentially increase firm value. Furthermore, Agency Theory (Jensen & Meckling, 1976) posits that institutional ownership functions as a monitoring mechanism to ensure that managers act in the best interest of shareholders, ultimately improving firm performance and market value.

The PBV ratio is generally calculated as follows:

$$\text{PBV} = \text{Market Price per Share} / \text{Book Value per Share}$$

Sustainability reporting involves disclosing non-financial information related to environmental, social, and governance (ESG) aspects of corporate operations. These reports offer transparency to investors regarding a company's commitment to sustainability and social responsibility. According to Sukoharsono and Andayani (2021), sustainability reports serve to highlight corporate initiatives aimed at managing the social and environmental impact of their activities. Higher levels of disclosure in these reports often enhance investor confidence and, in turn, positively affect firm value.

Empirical studies support this notion. For instance, Amin et al. (2023) found that firms with high levels of sustainability disclosure tend to perform better financially, which contributes to an increase in firm value. However, Amin and Susanti (2021) also noted that the impact of sustainability reporting on firm value may not be significant in certain sectors, depending on market perceptions and other variables such as financial performance.

In the pharmaceutical sector, which faces complex challenges related to regulatory compliance and health issues, sustainability reporting plays a crucial role. Prasetyo (2024) demonstrated that enhanced sustainability disclosures could boost market confidence and improve financial performance, thereby increasing firm value.

Institutional ownership refers to the proportion of company shares held by institutional investors such as banks, investment firms, insurance companies, and pension funds. Agency Theory (Jensen & Meckling, 1976) suggests that institutional ownership serves as an effective monitoring tool to mitigate agency conflicts between managers and shareholders. Signaling Theory also applies in this context. Ross (1977) stated that managers, who possess superior information about the firm, tend to disclose such information to convey positive signals to investors. Large institutional ownership often results in better governance and stricter oversight, which ultimately leads to improved firm value.

Supporting this, Rahmasari and Trisnarningsih (2021) found that high institutional ownership has a positive impact on firm value, as institutional investors typically drive firms toward better management and governance practices. Nevertheless, Fosu et al. (2016) emphasized that the influence of institutional ownership on firm value may vary depending on market dynamics and information asymmetry between managers and investors.

Enterprise Risk Management (ERM) is a comprehensive and integrated approach to identifying, assessing, and managing various risks faced by a company. According to COSO (2017), ERM is a process implemented across an organization to create, preserve, and realize value through effective risk management. Proper implementation of ERM can enhance corporate stability and reduce uncertainties faced by investors, thereby increasing firm value.

Solikhah and Hariyati (2019) argued that firms with robust ERM frameworks tend to be more stable and efficient, leading to improved performance and higher firm value. In the pharmaceutical industry, where companies deal with regulatory risks and rely heavily on R&D activities, effective ERM practices are essential for maintaining stability and safeguarding firm value.

Financial performance is commonly assessed using profitability ratios such as Return on Assets (ROA), which measures how efficiently a company utilizes its assets to generate profits. According to Pradita (2019), ROA has a positive influence on firm value, as highly profitable firms are generally more attractive to investors, driving up stock demand and consequently, firm value.

Moreover, Pradita (2019) explained that firms with high ROA demonstrate better overall performance and investor appeal, which increases share prices and firm value. A strong financial performance may also influence managerial decisions, including risk management strategies and sustainability disclosures, thereby reinforcing its role as a mediating variable in firm valuation.

3. Research Method

This study employs a causal research design aimed at testing the influence between independent and dependent variables. The approach used is quantitative, utilizing secondary data derived from financial reports, sustainability reports, and publicly available data on institutional ownership and enterprise risk management.

The population of this research includes all pharmaceutical companies listed on the Indonesia Stock Exchange (IDX) during the 2018–2023 period, totaling 11 companies. The sample consists of pharmaceutical firms that meet specific criteria, namely those with complete annual and sustainability reports as well as available data on institutional ownership and risk management. Sampling was conducted using purposive sampling, which involves selecting companies based on predetermined criteria. A total of 6 companies qualified for the final sample.

The data analysis method used in this study includes both descriptive and inferential statistics, conducted using EViews version 10. The analysis stages are as follows:

1. Descriptive Statistics
2. Panel Data Regression Analysis
3. Classical Assumption Testing
4. Model Fit Test (Q^2 Predictive Relevance)
5. Hypothesis Testing, including
 - a) Partial Test (t-test)
6. Sobel Test for mediation analysis

4. Results and Discussion

Descriptive Statistics Test

Descriptive statistics aim to understand the characteristics of each variable in the research sample. Table 1 presents the descriptive statistics results:

Table 1. Descriptive Statistics Results

Variable	Mean	Median	Maximum	Minimum	Std. Dev.
SR	0.43	0.33	0.99	0.13	0.22
KI	0.78	0.85	1.00	0.41	0.16
ERM	0.88	0.93	1.00	0.75	0.11
ROA	0.05	0.06	0.31	-0.95	0.20
PBV	6.99	3.62	41.27	-2.24	10.59

Based on the data in Table 1, the characteristics of the independent and dependent variables are as follows:

- Sustainability Report (SR):** The average level of sustainability disclosure among firms is 43%, with a relatively high variability (standard deviation of 0.22), indicating that while some companies report extensively, others disclose significantly less.
- Institutional Ownership (KI):** The average institutional shareholding is 78%, reflecting a relatively high level of ownership by institutional investors. The low standard deviation of 0.16 indicates consistent ownership levels across firms.
- Enterprise Risk Management (ERM):** The average ERM implementation rate is 88%, suggesting that most companies have adopted strong risk management systems. A low standard deviation of 0.11 indicates relatively uniform application across the sample.
- Return on Assets (ROA):** The average ROA is 0.05, indicating that most firms generate modest profits relative to their total assets. The high variability (standard deviation of 0.20) suggests that some firms even experienced losses (minimum value of -0.95).
- Price to Book Value (PBV):** The average PBV is 6.99, indicating that, on average, the market values these companies well above their book value. However, the range is wide (from -2.24 to 41.27), suggesting a mix of firms with extremely high or even negative market valuations.

Panel Data Regression

The panel data regression analysis was conducted using two models with three alternative testing approaches:

a. Chow Test

Table 2. Chow Test Results – Model 1

Test Type	Statistic	d.f.	Prob.
Cross-section F	9.354680	(5,26)	0.0000
Cross-section Chi-square	37.053143	5	0.0000

The results in Table 2 show that the probability value is $0.000 < 0.05$, thus H_0 is rejected and the Fixed Effect Model is preferred over the Common Effect Model.

Table 3. Chow Test Results – Model 2

Test Type	Statistic	d.f.	Prob.
Cross-section F	2.796816	(5,27)	0.0368
Cross-section Chi-square	15.024487	5	0.0103

The results in Table 3 also indicate that the Fixed Effect Model is more appropriate than the Common Effect Model since $0.0103 < 0.05$.

b. Hausman Test

Table 4. Hausman Test Results – Model 1

Test Summary	Chi-Sq. Statistic	d.f.	Prob.
Cross-section random	3.078625	4	0.5448

The probability value of $0.5448 > 0.05$ means that H_0 is accepted; therefore, the Random Effect Model is more suitable than the Fixed Effect Model.

Table 5. Hausman Test Results – Model 2

Test Summary	Chi-Sq. Statistic	d.f.	Prob.
Cross-section random	3.548205	3	0.3146

With a probability value of $0.3146 > 0.05$, the Random Effect Model is again more appropriate than the Fixed Effect Model.

c. Lagrange Multiplier (LM) Test

Table 6. LM Test Results – Model 1

Test Hypothesis	Cross-section	Time	Both
Breusch-Pagan	10.69755 (0.0011)	1.319419 (0.2507)	12.01697 (0.0005)

The LM Test for Model 1 yields a cross-section Breusch-Pagan probability of $0.0011 < 0.05$, suggesting that the Random Effect Model is preferred over the Common Effect Model.

Table 7. LM Test Results – Model 2

Test Hypothesis	Cross-section	Time	Both
Breusch-Pagan	0.600445 (0.4384)	0.012580 (0.9107)	0.613025 (0.4337)

Table 7 shows that the cross-section Breusch-Pagan probability is $0.4384 > 0.05$, indicating that the Common Effect Model is more appropriate than the Random Effect Model.

Classical Assumption Tests

Classical assumption testing is a series of statistical procedures performed prior to multiple linear regression analysis to ensure the model meets essential criteria for BLUE (Best Linear Unbiased Estimator) estimations. These tests aim to verify the validity and reliability of regression results, ensuring accurate interpretation of coefficient estimates. The tests include normality, multicollinearity, and heteroskedasticity assessments. The results are as follows:

a. Normality Test

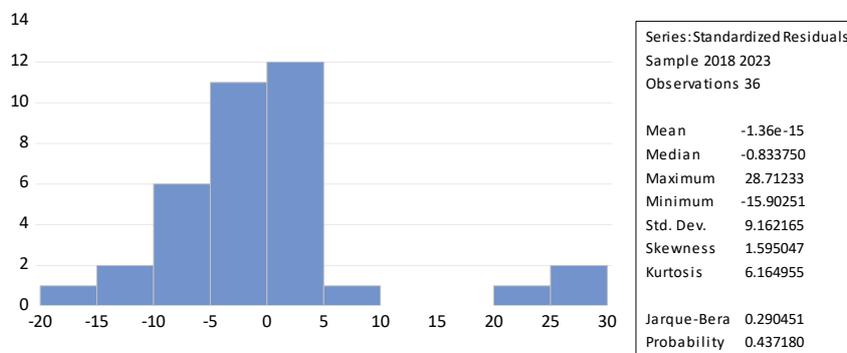


Figure 1. Normality Test Result – Model 2

The normality test for Model 2 was conducted using the Jarque-Bera test in EViews 12, yielding a probability of 0.437180. Since the significance level of $0.43 > 0.05$, it can be concluded that the data in the common effect model are normally distributed. For Model 1, which uses the Random Effect Model, the normality test was not performed as it is not a primary requirement for model validity.

b. Multicollinearity Test

Table 8. Multicollinearity Test Result – Model 1

	SR	KI	ERM	ROA
SR	1	0.231	0.473	0.182
KI	0.231	1	0.199	-0.267
ERM	0.472	0.199	1	0.332
ROA	0.182	-0.267	0.332	1

All correlation coefficients are below 0.8, indicating no multicollinearity problems in Model 1 (Shrestha, 2020).

Table 9. Multicollinearity Test Result – Model 2

	ROA	SR	KI	ERM
ROA	1	0.182	-0.267	0.332
SR	0.1816	1	0.2311	0.4729
KI	-0.2669	0.2310	1	0.1994
ERM	0.3316	0.4729	0.1994	1

Similarly, the correlation coefficients between independent variables in Model 2 are all below 0.8, confirming the absence of multicollinearity.

c. Heteroskedasticity Test

Table 10. Heteroskedasticity Test Result – Model 2

Panel Cross-section Heteroskedasticity LR Test				
Equation: CEM1				
Specification: PBV C SR KI ERM ROA				
Null hypothesis: Residuals are homoskedastic				
	Value	df	Probability	
Likelihood ratio	103.3062	6	0.0000	
LR test summary:				
	Value	df		
Restricted LogL	-130.3177	31		
Unrestricted LogL	-78.66459	31		

Since the p-value is less than 0.05, the null hypothesis (H0) stating that residuals are homoskedastic is rejected. This implies the presence of heteroskedasticity in the panel data model. For Model 1, the heteroskedasticity test is not required under the Random Effect Model (REM), which already accounts for variance differences across panel units.

Predictive Relevance (Q²) Test

The predictive relevance value (Q²) is calculated based on the adjusted R² values for both dependent variables. The adjusted R² value for firm value (R₁²) is 0.295042, and the adjusted R² value for return on assets (R₂²) is 0.373073. Thus, the Q² value is calculated as follows:

$$Q^2 = 1 - (1 - 0.295042)(1 - 0.373073)$$

$$Q^2 = 1 - (0.704958 \times 0.626927)$$

$$Q^2 = 1 - 0.44199$$

$$Q^2 = 0.5580$$

A Q² value above 0.5 indicates that the model possesses strong predictive relevance. Therefore, the model demonstrates good predictive capability, particularly in explaining firm value and financial performance.

Hypothesis Testing

a. Model 1: Partial Test (t-test)

Table 11. Partial Test Results – Model 1

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	16.10425	18.51910	0.869602	0.3912
SR	3.604535	9.326255	1.386493	0.0017
KI	0.619747	9.867743	1.062805	0.0032
ERM	-12.98319	21.46032	2.604985	0.0005
ROA	0.248530	0.071869	3.458092	0.0016

Equation:

$$\text{Firm Value} = 16.10425 + 3.604535(\text{SR}) + 0.619747(\text{KI}) - 12.98319(\text{ERM}) + 0.248530(\text{ROA})$$

- Sustainability Report (SR):** Significant positive effect on firm value (p = 0.0017 < 0.05).
- Institutional Ownership (KI):** Significant positive effect on firm value (p = 0.0032 < 0.05).
- Enterprise Risk Management (ERM):** Significant (though negative) effect on firm value (p = 0.0005 <

0.05).

4. **Return on Assets (ROA):** Significant positive effect on firm value ($p = 0.0016 < 0.05$).

b. Model 2: Partial Test (t-test)

Table 12. Partial Test Results – Model 2

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-30.51260	28.38526	-1.074945	0.2919
SR	11.14782	16.57239	0.672674	0.0046
KI	45.43015	19.93126	2.279345	0.0308
ERM	75.29720	32.14260	2.342598	0.0268

Equation:

$$\text{Financial Performance (ROA)} = -30.51260 + 11.14782(\text{SR}) + 45.43015(\text{KI}) + 75.29720(\text{ERM})$$

1. **Sustainability Report (SR):** Significant positive effect on ROA ($p = 0.0046 < 0.05$).
2. **Institutional Ownership (KI):** Significant positive effect on ROA ($p = 0.0308 < 0.05$).
3. **Enterprise Risk Management (ERM):** Significant positive effect on ROA ($p = 0.0268 < 0.05$).

Path Analysis (Mediation Test using Sobel Test)

Table 13. Path Analysis Results

Variable	t-count	t-table	Conclusion
SR	0.660	1.6	Not Significant
KI	1.903	1.6	Significant
ERM	1.939	1.6	Significant

The results in Table 13 reveal that institutional ownership (KI) and enterprise risk management (ERM) have a significant indirect effect on firm value through financial performance (ROA), as their t-values exceed the critical value of 1.6. Meanwhile, the sustainability report (SR) does not have a significant indirect effect on firm value via financial performance, as its t-value is below the threshold.

This indicates that while SR may directly impact firm value and financial performance, it does not significantly transmit its effect through financial performance as a mediating variable. Conversely, KI and ERM demonstrate their influence both directly and indirectly, suggesting that improved institutional ownership and risk management strategies not only enhance financial performance but also translate into increased firm value through this mediating mechanism.

5. Conclusion and Recommendations

Conclusion

This study investigates the determinants of firm value in pharmaceutical companies listed on the Indonesia Stock Exchange between 2018 and 2023, with financial performance (ROA) as a mediating variable. The findings indicate that:

1. Sustainability reporting, institutional ownership, enterprise risk management, and return on assets all have significant direct effects on firm value.
2. ROA significantly mediates the relationship between institutional ownership and enterprise risk

- management with firm value.
3. However, the mediating effect of ROA in the relationship between sustainability reporting and firm value is not statistically significant.

These results underscore the importance of strong financial performance and robust governance mechanisms, including institutional oversight and risk management practices, in enhancing firm value. Although sustainability reporting contributes positively to transparency and performance, it may require additional support from financial outcomes to significantly influence firm value.

Recommendations

1. For Company Management: Pharmaceutical companies should strengthen their enterprise risk management and ensure transparency in ownership structures, as both elements improve financial outcomes and long-term value. While sustainability disclosures are important, they should be aligned with strategic performance indicators to generate more impactful investor responses.
2. For Investors: In addition to evaluating profitability indicators, investors are encouraged to assess institutional ownership and risk management systems as part of their investment decision-making process, as these elements are shown to influence firm valuation.
3. For Future Research: Future studies may consider incorporating moderating variables such as corporate governance quality, auditor reputation, or firm size to better understand the dynamics between sustainability practices, financial performance, and firm value. A broader sectoral approach and extended observation period may also enrich the generalizability of findings.

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