

# Does greenwashing create value of the firm? The moderating role of political connection

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## Abstract

This study examines the relationship between greenwashing and firm value, along with the moderating role of political connections, using a sample of 28 non-loss firms from the Indonesia Stock Exchange LQ45 index from 2020 to 2024 making 140 firm year observations. Framed within stakeholder theory, the research hypothesizes that greenwashing negatively affects firm value and that political connections enhance firm value and weaken the negative effect of greenwashing. The results, based on a Moderated Ordinary Least Square (OLS) model, indicate that greenwashing is not statistically significant in explaining firm value. Surprisingly, political connection is found to negatively affect firm value. Crucially, the interaction term of greenwashing and CEO political connection is also not significant, indicating that CEO political connection does not moderate the relationship. This non-significant impact of greenwashing contradicts much of the international literature and suggests that, in the Indonesian context, stakeholders may face challenges in verifying environmental claims, allowing firms to avoid immediate short-term financial penalties. The study highlights a potential regulatory gap, emphasizing the need for policymakers to mandate stricter environmental disclosure and transparency.

Keywords: Greenwashing, Political Connection, Firm Value, Indonesia

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## INTRODUCTION

Several studies have demonstrated that one of the key dimensions of Environmental, Social, and Governance (ESG), namely the environmental aspect, plays a crucial role in enhancing firm value as part of the broader framework of sustainable investment (Aydoğmuş et al., 2022; Makhdalena et al., 2023; Setya Permana & Tjahjadi, 2020; Shakil et al., 2019). The environmental pillar of ESG focuses on how corporations manage their interactions with the natural environment, including resource efficiency, waste management, carbon emissions reduction, and environmental innovation (Nirino et al., 2022). In Indonesia, the adoption of environmental principles has gained increasing attention, particularly within the corporate sector. Regulatory bodies and the Indonesia Stock Exchange (IDX) have encouraged listed firms to integrate environmental strategies, disclosures, and performance indicators into their operational and reporting frameworks (Setya Permana & Tjahjadi, 2020). This development reflects a growing alignment between corporate objectives and the United Nations Sustainable Development Goals (SDGs), emphasizing that profitability and sustainability are not mutually exclusive but rather complementary.

This trend also aligns with Freeman's (1984) stakeholder theory (Freeman, 1984), which posits that a firm's success depends on its ability to create value for all stakeholders—shareholders, employees, customers, suppliers, the community, and the environment—rather than focusing solely on profit maximization. Within this framework, corporate engagement in environmental sustainability becomes a strategic response to stakeholder expectations. Increasingly, investors integrate ethical, social, and environmental considerations into their investment decisions, viewing them as indicators of sound governance and risk mitigation (Signori et al., 2021). As a result, firms are incentivized to adopt sustainability-oriented policies not only as a matter of compliance but as a source of competitive advantage and legitimacy in an era of heightened stakeholder awareness.

Despite these positive developments, debate persists over the effectiveness and authenticity of ESG and sustainable investment frameworks (Talan et al., 2024). Critics argue that some corporations may adopt these initiatives only superficially—an act known as greenwashing—to project an environmentally friendly image without undertaking substantial actions to reduce their ecological footprint (Free et al., 2024). This phenomenon raises serious concerns regarding the credibility of corporate sustainability reporting and the trustworthiness of ESG performance claims. Empirical findings on the impact of greenwashing remain mixed and inconclusive. Some scholars suggest that greenwashing undermines firm value, as it generates information asymmetry, damages corporate reputation, and erodes stakeholder confidence (Cao et al., 2022; Gregory, 2024; Xu et al., 2023). In contrast, other research contends that greenwashing may temporarily enhance firm value, since it allows firms to demonstrate apparent responsiveness to stakeholder and regulatory pressures, or to maintain social legitimacy amid increasing demands for sustainability performance (Chen & Dagestani, 2023; Du, 2015; Fu et al., 2024).

In emerging economies like Indonesia, where government intervention and political influence remain significant, corporate relationships with political actors can critically affect both strategic decision-making and public perception. External institutional pressures—such as the need to conform to government expectations or secure access to regulatory benefits—can drive firms to engage in greenwashing as a means of legitimizing their operations within prevailing institutional norms (Zheng & Li, 2024). Moreover, politically connected firms often possess greater access to information, resources, and networks that can enhance their corporate image and perceived legitimacy, potentially mitigating the negative perception of greenwashing among stakeholders (R. Sun & Zou, 2021). At the same time, political connections may also serve as a monitoring mechanism, fostering stronger alignment with public sustainability objectives through government oversight and engagement (Bani-Khalid & Al-Own, 2020).

Thus, political connections can exert dual and complex effects: on one hand, they may encourage opportunistic behavior such as greenwashing to maintain legitimacy; on the other hand, they may reduce such practices by enhancing accountability and stakeholder scrutiny. Theoretically, the reduction of greenwashing through external monitoring could improve firm value by lowering the risk of misleading or unreliable environmental disclosures (Gregory, 2024). This conceptual reasoning highlights the potential of political connections as a moderating variable in the relationship between greenwashing and firm value. However, to date, limited research has explicitly integrated political connections into this relationship, especially within the context of emerging markets such as Indonesia.

Therefore, this study aims to address this gap by examining the moderating role of political connections in the nexus between greenwashing and firm value, framed within stakeholder theory. By doing so, this research contributes to the literature by extending existing theoretical perspectives that have previously relied on legitimacy theory (Zheng & Li, 2024) and institutional theory (Can & Turker, 2024) to explain corporate environmental behavior. Integrating these perspectives provides a more comprehensive understanding of how corporate legitimacy, institutional pressures, and stakeholder relationships interact to influence firm outcomes in the era of sustainability-oriented business practices.

## LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### What is Greenwashing; Environmental Practices in Indonesia

Greenwashing is a significant concern in environmental marketing, characterized by companies making false or misleading claims about the environmental benefits of their products or services. This deceptive practice aims to appeal to environmentally conscious consumers, yet it often results in the opposite effect by eroding consumer trust and damaging the brand's reputation (Seberini et al., 2024). Greenwashing not only poses ethical questions but also affects brand credibility and green brand equity. Research shows that these practices negatively impact brand reputation and credibility, as consumers become increasingly aware of the discrepancies between a company's marketing claims and its actual environmental performance (Amer & Ezz, 2023). Additionally, the pervasive nature of

greenwashing disrupts consumer perceptions and hinders genuine sustainable development, as it manipulates consumer behavior and impedes authentic environmental progress (Singh & Manoharan, 2024).

Various studies have explored the effects of greenwashing, emphasizing the need for companies to engage in authentic and transparent green marketing strategies. Authentic communication and genuine commitment to environmental values are crucial for establishing a positive green brand image and reducing the perception of greenwashing (Tu et al., 2024). Moreover, addressing greenwashing requires increased consumer literacy and awareness of deceptive marketing tactics, as well as collaborative efforts from policymakers and stakeholders to ensure accountability and promote genuine sustainability initiatives (Fernandes et al., 2020).

In Indonesia, companies are increasingly engaging in environmental practices to improve sustainability, driven by various government initiatives, industry needs, and global standards. The Program for Pollution Control, Evaluation, and Rating (PROPER), launched by the Indonesian Ministry of Environment, plays a crucial role in assessing and rating the environmental performance of companies, though the level of formal environmental disclosures remains low (Wahyuningrum et al., 2020). Enterprises in adopting eco-innovation benefit from eco-regulations and government support.

These factors, coupled with eco-environmental elements like eco-competition and eco-process innovations, promote better sustainable practices (Achmad et al., 2023). Notably, firms have adopted greener practices by integrating eco-innovation into production processes, guided by regulations and market demand for sustainable products (Fernando et al., 2016). However, in industries like palm oil, while there is some emphasis on environmental and social strategies, the overall focus and implementation are still lacking, highlighting the need for stronger governance and leadership (Wardhani & Rahadian, 2021).

### **Greenwashing and Firm Value**

The impact of greenwashing on firm value is multifaceted, revealing both positive and negative consequences but more on the latter. On one hand, greenwashing, a practice where firms exaggerate or falsely communicate their environmentally friendly practices, is found to improve firm value by enhancing disclosure quality and reducing financing constraints, particularly benefiting heavily polluting enterprises and those audited by prominent firms (Chen & Dagestani, 2023). Conversely, numerous studies highlight the adverse effects of greenwashing on firm valuation. A significant reduction in "shared value" creation is observed when companies engage in deceptive sustainability reporting, suggesting that greenwashing erodes trust and economic value (Xu et al., 2023). Furthermore, investor attention plays a critical role in governance against greenwashing by inhibiting such practices through informed scrutiny (Li et al., 2024).

Corporate greenwashing also affects investor behavior, as prosocial investors are noted to divert their investments away from companies accused of greenwashing. Institutional investors, although initially encouraging ESG disclosures, may indirectly promote greenwashing by discouraging the use of genuine sustainability phrases, a trend that has seen a decline post-implementation of stricter environmental guidelines (Zhu et al., 2025). Additionally, managerial decision-making horizons influence greenwashing tendencies, where short-term focus exacerbates these practices (Yu et al., 2024). Employees are not immune to the effects of greenwashing, with increased perceptions of organizational hypocrisy leading to higher turnover intentions, particularly in employees educated in sustainability fields (Robertson et al., 2023). Greenwashing in corporate communications can undermine financial market performance, emphasizing the detrimental impact of inauthentic CSR communications (Oppong-Tawiah & Webster, 2023).

Stakeholder theory posits that the value of a firm is determined by its ability to account for and balance the interests of all its stakeholders, which include not just investors and shareholders, but also customers, employees, suppliers, and the broader community. In this context, greenwashing, which involves misleading stakeholders about a company's environmental practices, is particularly detrimental, and long-term effects are often negative. Greenwashing undermines trust and can lead to

skepticism among stakeholders, which harms firm value over time. For example, stakeholders such as sustainability managers experience decreased job satisfaction and performance when they perceive their firm's environmental claims as deceptive, potentially leading to higher turnover intentions and a loss of valuable talent (Westerman et al., 2022). This erosion of trust extends to employees more broadly, where greenwashing in corporate social responsibility efforts can significantly decrease employee trust and identification, ultimately affecting loyalty and performance (Mu & Lee, 2023). Moreover, from a managerial perspective, decisions influenced by greenwashing may include the continuation of alliances with deceptive partners, affecting long-term strategic partnerships and market positioning (Ferrón-Vílchez et al., 2020). In cases where stakeholders detect greenwashing, there is potential for reputational damage, which further depreciates firm value and undermines corporate legitimacy (Torelli et al., 2019). To mitigate these adverse effects, companies are encouraged to align their corporate social responsibility strategies with transparent and genuine stakeholder engagement practices (Vollero et al., 2016). The stakeholder theory underscores the importance of authentic engagement and transparency in initiatives related to environmental responsibility, where greenwashing poses a significant risk to maintaining stakeholder trust and sustaining firm value in the long run, therefore,

*H1: Greenwashing lowers firm value.*

### **Moderating role of political connection**

The relationship between CEO political connections and firm value has been a focal point in various studies. A study on IPO performance in China indicates that CEO political connections significantly enhance a firm's capacity to raise capital in public markets, especially when connected to the central government (Wu et al., 2012). Another research examines the dynamics of CEO turnover and finds that politically connected CEOs in China are less likely to be dismissed, and these connections yield economic benefits, particularly when firm profitability is below the industry average (You & Du, 2011). The influence of political connections on firm performance is further highlighted in a separate analysis, showing positive impacts on cash holdings, long-term loans, and reduced financing costs in Chinese companies (Su & Fung, 2013).

Additionally, the interplay between CEO political ideology and firm inventiveness reveals that political connections can also be influential in shaping innovation and technological trajectories (Kiss et al., 2024). In the context of China's publicly traded firms, the study found that the 'star CEO' status, often linked with political connections, plays a crucial role in enhancing firm performance and CEO compensation, although it is largely the political connectedness rather than talent driving these premiums (Conyon et al., 2015). Similarly, the development of political ties as part of a firm's nonmarket strategy can greatly enhance firm performance depending on market conditions and other contingent factors (P. Sun et al., 2012).

*H2: Political connection enhances firm value.*

Greenwashing tends to taint the perceived value of a firm due to the erosion of stakeholder trust and questionable ethical practices (Ferrón-Vílchez et al., 2020; Torelli et al., 2019; Westerman et al., 2022). However, when political connections are factored in, the dynamics can shift considerably. Firms with strong political ties might leverage these relationships to mitigate the negative perception arising from greenwashing. These connections can serve as a buffer against stringent regulatory scrutiny, reducing external pressures such as media backlash and government penalties, thereby maintaining or even enhancing firm value despite engaging in greenwashing activities (Chen & Dagestani, 2023; Liu et al., 2024).

The political clout provides firms with advantages such as favorable policy treatments, access to subsidies, and a reduced likelihood of punitive measures that can arise from deceptive environmental claims. This protection can allow firms to sustain their market value and can even lead them to exploit greenwashing as a strategy to attract investments under the guise of being environmentally responsible. Consequently, the moderation by political connections may lead to a more pronounced effect of greenwashing on firm value by enhancing the credibility or shielding the firm from negative market reactions (Zhang et al., 2022).

However, this dynamic also presents ethical concerns and highlights the need for regulatory frameworks to address the role of political connections in mitigating the negatives of greenwashing. Firms in politically connected industries can capitalize on these ties at the cost of genuine sustainability efforts, thereby necessitating stronger governance and regulatory measures to ensure that greenwashing does not get further entrenched as an accepted practice in achieving short-term financial gains at the expense of long-term sustainability goals (Liu et al., 2024).

*H3: Political connection weakens negative effect of greenwashing on firm value.*

## METHODS

### Sample

The sample used in this study comprises companies listed in the LQ45 index of the Indonesia Stock Exchange (IDX). The LQ45 index consists of 45 firms selected based on their superior market capitalization and liquidity, reflecting the most active and financially robust companies in Indonesia. The observation period spans from 2020 to 2024, and due to LQ45 firms list changes every semester, we include firms that consistently listed on the index, and those are not in loss, providing 28 firms that make 140 firm year-observations. The LQ45 index is perceived as a stable option due to its inclusion of well-established companies across various sectors. This index is also monitored for broader economic trends and investor sentiment (Choiriyah et al., 2021; Fauzan et al., 2024). Moreover, the inclusion of Environmental, Social, and Governance (ESG) indicators within firms in the LQ45 facilitates an evaluation of how environmental policies influence company performance and market perception. Additionally, the diversified representation of various sectors in the LQ45 provides a broad spectrum for assessing industry-specific environmental practices, enabling a comprehensive understanding of how different industries tackle environmental challenges.

### Empirical model

We use moderated ordinary least square model as described below.

$$MV_{it} = \beta_0 + \beta_1 GW_{it} + \beta_2 POL_{it} + \beta_3 POL_{it} * GW_{it} + \beta_4 Controls_t + e$$

MV or market value of shares (Kumar & Shetty, 2018), serves as dependent variable. GW or greenwashing serves as the first independent variable. We use measurement from Zhou & Wang (2024), that a firm is considered to engage in greenwashing behavior when there are statements related to environmental protection activities, yet no actual environmental protection expenditures are recorded for the corresponding year. GW is defined as the frequency of words or statements related to environmental protection in the annual report if the firm reports no environmental protection expenses in that year; otherwise, the variable takes the value of zero. POL or political connection serves as the second independent variable. We employ political connection measurement from Conyon et al. (2015). POL is defined as a dummy variable that equals 1 if the firm's CEO currently holds or has previously held a position in the government, and 0 otherwise. The interaction variable  $POL_{it} * GW_{it}$  is used to assess the moderation of political connection.

Control variables used are EPS (Earning per Share), Debt-to-Equity (DER), and firm size. EPS were shown to positively influence firm value, indicating the profitability resulting from a firm's capacity to innovate continuously has a constructive impact on value creation (Asni & Agustia, 2021). DER demonstrated a negative relationship with firm value, as indicated by a higher DER, may detract from firm performance and value (Chinedu et al., 2014). Firm size positively affect firm financial performance, meaning larger firms, by virtue of their size, can better manage and leverage their disclosures to enhance financial performance (Bedi & Singh, 2024).

## RESULT AND DISCUSSION

### Statistic descriptives and correlation

We begin the analysis with descriptives and correlation as shown on Table 1. Firm value is positively correlated by greenwashing, EPS and firm size, and negatively by political connection and DER.

**Table 1.** Descriptives and correlation

Variables	<i>MV</i>	<i>GW</i>	<i>POL</i>	<i>EPS</i>	<i>DER</i>	<i>TAS</i>
<i>Obs.</i>	140	140	140	140	140	140
<i>Mean</i>	5690.942	3.21428	0.071	703.275	2.238	8.025
<i>Std. dev</i>	6787.498	5.475	0.258	1703.694	2.818	0.664
<i>Min</i>	39025	22	1	14613.6	11.85	9.329
<i>Max</i>	496	0	0	2.71	0.17	6.573
<i>MV</i>	1					
<i>GW</i>	0.069	1				
<i>POL</i>	-0.156	-0.133	1			
<i>EPS</i>	0.797	-0.018	-0.054	1		
<i>DER</i>	-0.133	-0.164	-0.029	-0.155	1	
<i>TAS</i>	0.132	-0.022	-0.038	-0.005	0.653	1

Source: author's work

We conduct OLS regression to the main model, to investigate the relationship between greenwashing (GW) and political connections (POL) towards firm value (MV). Afterwards we assess political connection moderation with interactive variables (GW\*POL) to test our hypothesis. The result is seen on Table 2.

**Table 2.** Regression result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
<i>GW</i>	58.05253	62.49114	0.928972	0.3546
<i>POL</i>	-2803.601	1391.026	-2.015492	0.0459**
<i>EPS</i>	3.059294	0.198430	15.41750	0.0000***
<i>DER</i>	-404.1788	162.3400	-2.489706	0.0140**
<i>TAS</i>	2476.395	669.0203	3.701524	0.0003**

Source: author's work

Based on Table 2, GW is not significant ( $p = 0.35$ ), meaning there is no relationship between greenwashing and market value of the firm, in Indonesia Stock Exchange LQ45 index, therefore Hypothesis 1 is not supported. This result contradict with previous studies (Ferrón-Vílchez et al., 2020; Torelli et al., 2019; Westerman et al., 2022), that greenwashing lowers firm value because greenwashing is a deceptive practice that could mislead investor decisions. Possible explanation for this contradiction is the perception and reaction. Some studies, such as the one focusing on perceived greenwashing, suggest that while stakeholders may initially react negatively to greenwashing, these sentiments might not translate into significant financial penalties for firms in the short term. This lack of immediate impact could be due to the difficulties stakeholders encounter when attempting to verify the authenticity of a company's environmental claims, thereby reducing the perceived risk associated with greenwashing.

According to stakeholder theory, a business should focus not only on maximizing shareholder returns but also on considering the interests of all stakeholders, including customers, employees, communities, and the environment. Greenwashing, the practice of misleading stakeholders about a company's environmental performance, can be seen as a breach of stakeholder theory principles because it prioritizes superficial image over genuine stakeholder engagement. Furthermore, the impact of greenwashing on shared value creation—value that benefits both the company and society—can be detrimental, as it increases information asymmetry and leads to a lower perceived shared value (Xu et al., 2023). While greenwashing is often considered unethical and potentially harmful, its ambiguous

impact on firm value suggests that it does not always result in immediate, substantial financial repercussions, allowing some firms to navigate short-term gains without an evident loss in value.

POL is negatively significant ( $p = 0.04$ ), which explains CEO political connection lowers firm value, and therefore, H2 is not supported. This result is not align with previous research (Conyon et al., 2015; Wu et al., 2012; You & Du, 2011). Possible explanation is politically connected firms may become entangled in complex relationships with government officials, leading to decisions driven by vested interests rather than optimal business strategies. Based on stakeholder theory, such ties can create conflicts when the interests of politicians—often involved as stakeholders—diverge from those of other shareholders, ultimately diluting shareholder value (Pang & Wang, 2020) Moreover, political connections can weaken a firm's competitive dynamism, as firms may rely on their connections to navigate bureaucratic hurdles rather than investing in innovation and efficiency, resulting in stagnation in productivity and competitiveness (Akcigit et al., 2023). Additionally, these connections can expose firms to reputational risks and public scrutiny, particularly if they imply preferential treatment or unethical practices such as corruption or favoritism, thereby undermining transparency, stakeholder trust, and long-term firm value (Mohammed et al., 2017; Pang & Wang, 2020; Saeed et al., 2015).

Table 3 presents POL moderation to the relationship between GW and MV, and it is revealed that the interaction variable is not significant ( $p = 0.89$ ), therefore POL does not moderate the relationship. It is due to multiple inherent dynamics within corporate governance and external influences. Political connections may offer firms certain strategic advantages, such as increased access to resources and favorable treatment from regulatory bodies. Political ties can create a protective shield for CEOs, allowing them to leverage these relationships to avoid accountability for misleading environmental claims and reports (You & Du, 2011). Consequently, while political connections might appear to offer a pathway for enhancing firm performance, they often exacerbate the degree to which a firm engages in greenwashing practices, contrary to fostering genuine CSR efforts (Chen & Dagestani, 2023). Additionally, the effectiveness of political connections as a moderating force is undermined by the fact that these connections often align with regional and industry-specific norms and pressures that prioritize financial performance over ethical practices, further diminishing their capacity to counteract the negative impacts of greenwashing on long-term firm value (Wu et al., 2012). Therefore, while political connections can indeed affect firm dynamics, they often serve more to protect self-serving interests and sustain superficial compliance rather than nurturing substantive sustainability initiatives.

**Table 3.** Moderation result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
<i>GW</i>	58.05253	62.49114	0.928972	0.3546
<i>POL</i>	-2803.601	1391.026	-2.015492	0.0459**
<i>GW*POL</i>	112.101	829.8417	0.135088	0.8927
<i>EPS</i>	3.059294	0.198430	15.41750	0.0000***
<i>DER</i>	-404.1788	162.3400	-2.489706	0.0140**
<i>TAS</i>	2476.395	669.0203	3.701524	0.0003**

Source: author's work

## CONCLUSION

This research aims to investigate the relationship of greenwashing on firm value, and if CEO political connection moderate the relationship. The results conclude that, contrary to previous studies, greenwashing had no statistically significant impact on the market value of firms in the Indonesia Stock Exchange LQ45 index, and political connections offered no moderation effect. This suggests that stakeholders in this context may face difficulty verifying environmental claims, allowing firms to evade immediate financial penalties for deceptive practices. Practically, this non-significant result implies a regulatory gap, highlighting the necessity for policymakers to mandate stricter environmental

disclosure and enhance transparency mechanisms to ensure market efficiency and protect investors from information asymmetry. As a research limitation, the analysis relied on short-term market data. Future studies should adopt a longer time-series approach to capture the full, delayed effects of reputational damage on firm value and comprehensively assess the long-term efficacy of sustainability governance.

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