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ESG Decoupling, Political Connections And Stock Price Crash Risk Evidence From Indonesian Listed Firms

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Abstract: *This study investigates the effect of ESG Decoupling on Stock Price Crash Risk (SPCR) and examines the moderating role of Political Connections among non-financial firms listed on the Indonesia Stock Exchange. ESG Decoupling refers to the divergence between sustainability disclosure and actual environmental, social, and governance performance, reflecting the extent to which firms engage in symbolic sustainability reporting. Drawing upon Positive Accounting Theory, Legitimacy Theory, Signaling Theory, and the Bad News Hoarding Theory, this study argues that ESG Decoupling increases information asymmetry and encourages the accumulation of undisclosed adverse information, thereby elevating future stock price crash risk. The study employs a quantitative research design using panel data from 142 non-financial firms during the 2018–2024 period, resulting in 994 firm-year observations. ESG Disclosure Scores are obtained from Bloomberg, ESG Performance Scores from Refinitiv Eikon, and political connection data are manually collected from annual reports and corporate governance disclosures. Fixed-effects regression models are used to test the hypotheses, while System Generalized Method of Moments estimation is employed to address potential endogeneity concerns. The empirical results indicate that ESG Decoupling has a positive and statistically significant effect on Stock Price Crash Risk. Political Connections strengthen this relationship, suggesting that politically connected firms experience more severe adverse consequences when sustainability disclosures diverge from actual ESG performance. Robustness analyses using alternative measurements and dynamic specifications confirm the consistency of the findings. The study contributes to the emerging ESG literature by demonstrating that disclosure credibility represents a critical determinant of market stability and by highlighting the governance risks associated with political affiliations in emerging capital markets.*
Keywords: *ESG Decoupling, Stock Price Crash Risk, Political Connections, ESG Disclosure, Emerging Markets.*

INTRODUCTION

The capital market plays a strategic role in promoting economic growth by facilitating the efficient allocation of financial resources from investors to firms requiring capital for business expansion and innovation. An efficient capital market enables firms to obtain funding at lower costs while providing investors with opportunities to diversify risk and maximize returns. The effectiveness of capital market operations depends heavily on the availability of transparent, reliable, and timely information that supports investment decision-making. Information asymmetry between managers and investors may distort market efficiency and increase uncertainty regarding firm value (Jin & Myers, 2006).

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One consequence of information asymmetry that has attracted considerable attention in the accounting and finance literature is Stock Price Crash Risk (SPCR). Stock price crash risk refers to the likelihood of experiencing an extreme decline in stock prices resulting from the sudden release of accumulated negative information that had previously been concealed by management (Hutton et al., 2009). According to the bad news hoarding theory, managers may strategically delay the disclosure of unfavorable information to protect their personal interests, compensation, and reputational capital. The accumulation of undisclosed adverse information eventually reaches a critical threshold, forcing the market to rapidly adjust firm valuations and triggering substantial stock price declines (Jin & Myers, 2006; Kim et al., 2014).

Recent developments in global capital markets have highlighted the growing importance of Environmental, Social, and Governance (ESG) disclosure as an additional source of information used by investors to evaluate corporate sustainability and long-term performance. ESG disclosure is expected to reduce information asymmetry by providing stakeholders with a broader understanding of firms' environmental responsibility, social engagement, and governance quality. Prior studies indicate that high-quality ESG disclosure contributes to enhanced transparency, improved investor confidence, and lower capital costs (Gillan et al., 2021; Velte, 2023). The increasing integration of ESG considerations into investment decisions has encouraged regulators worldwide to strengthen sustainability reporting requirements.

Indonesia has responded to this development through the issuance of Financial Services Authority Regulation (POJK) No. 51/POJK.03/2017 concerning sustainable finance implementation for financial institutions, issuers, and public companies. The regulation requires listed companies to publish Sustainability Reports as a means of communicating their sustainability commitments and performance to stakeholders (Otoritas Jasa Keuangan, 2017). The implementation of mandatory sustainability reporting is expected to enhance corporate accountability and improve the quality of information available to investors.

Despite the growing emphasis on sustainability reporting, concerns have emerged regarding the credibility of ESG disclosures. Firms increasingly face pressure to demonstrate strong sustainability performance while maintaining profitability and competitive advantage. Such pressure may encourage companies to engage in greenwashing practices, whereby sustainability

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disclosures are used primarily to shape stakeholder perceptions rather than reflect actual organizational practices. This phenomenon is commonly referred to as ESG decoupling, which represents the divergence between ESG disclosure and ESG performance (Hawn & Ioannou, 2016). ESG decoupling creates an additional layer of information opacity because stakeholders may evaluate firms based on sustainability narratives that are not supported by substantive operational actions (Eliwa et al., 2023).

The consequences of ESG decoupling may become more severe in emerging economies characterized by weak institutional enforcement and strong political-business relationships. Political connections are widely recognized as valuable strategic resources that provide firms with privileged access to financing, government contracts, and regulatory protection (Faccio, 2006). In many developing countries, politically connected firms often enjoy advantages that may weaken external monitoring mechanisms and reduce managerial accountability. Indonesia represents a particularly relevant setting because political affiliations frequently exist within corporate governance structures, especially through appointments of former politicians, senior bureaucrats, and military officers to boards of commissioners (Harymawan et al., 2019). Such conditions raise concerns regarding whether political connections strengthen the adverse consequences of ESG decoupling on stock price crash risk.

Existing literature has documented the economic consequences of ESG practices and stock price crash risk. Most studies focus on the relationship between ESG performance, ESG disclosure, or corporate social responsibility and market outcomes such as firm value, financing costs, and stock price crash risk (Bae et al., 2021; Kim et al., 2014). A limited number of studies have shifted attention toward ESG decoupling, despite the growing concern regarding the credibility of sustainability reporting. Consequently, empirical evidence examining ESG decoupling as a determinant of stock price crash risk remains relatively scarce.

A contextual gap also exists because previous studies have predominantly been conducted in developed economies characterized by strong legal systems and effective regulatory enforcement. The Indonesian context offers unique institutional characteristics that may influence the relationship between ESG decoupling and stock price crash risk. The implementation of a two-tier board system, combined with the prevalence of political patronage within corporate

governance structures, creates a distinct environment that differs substantially from those examined in prior studies (Harymawan et al., 2019).

Methodological limitations are also evident in existing research. Most prior studies rely on aggregate ESG scores as proxies for sustainability performance without explicitly distinguishing between disclosure quality and actual ESG implementation. Relatively few studies employ ESG Disclosure Scores and ESG Performance Scores simultaneously to construct ESG decoupling measures. Such an approach provides a more comprehensive assessment of the divergence between sustainability narratives and substantive performance (Hawn & Ioannou, 2016; Hussain et al., 2025).

Based on the research background and identified gaps, this study addresses the following research questions:

RQ1: Does ESG Decoupling increase Stock Price Crash Risk among non-financial firms listed on the Indonesia Stock Exchange?

RQ2: Do Political Connections strengthen the positive relationship between ESG Decoupling and Stock Price Crash Risk?

This study offers several important contributions to the literature. From a theoretical perspective, the study extends Positive Accounting Theory, particularly the Political Cost Hypothesis, by explaining how sustainability disclosures may be strategically used to manage external perceptions while concealing unfavorable information. The study also integrates insights from Legitimacy Theory and Signaling Theory to explain why firms engage in ESG decoupling and how such practices affect investor perceptions and market outcomes.

From a practical perspective, the findings provide important implications for regulators, particularly the Financial Services Authority (OJK), regarding the need to strengthen verification and assurance mechanisms for sustainability reporting. The study also offers an early warning for investors by highlighting the potential risks associated with ESG disclosures that are not supported by actual sustainability performance. A better understanding of ESG decoupling and political connections may assist investors in evaluating corporate transparency and identifying firms that are vulnerable to future stock price crashes.

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Literature Review and Hypothesis Development

Positive Accounting Theory and Political Cost Hypothesis

Positive Accounting Theory (PAT) provides a fundamental framework for explaining managerial behavior in selecting accounting and disclosure policies. Watts and Zimmerman (1986) argue that managers act rationally to maximize their own utility while responding to contractual and political incentives. Among the three central propositions of PAT, the Political Cost Hypothesis is particularly relevant for understanding sustainability reporting behavior. The hypothesis suggests that firms facing greater public scrutiny and political attention tend to adopt reporting strategies aimed at minimizing regulatory intervention and social pressure.

The increasing importance of ESG issues has expanded the scope of political costs beyond traditional financial reporting. Firms operating in environmentally sensitive industries frequently encounter demands from regulators, environmental organizations, investors, and the public regarding their sustainability performance. Under these conditions, managers may strategically use ESG disclosures to create favorable perceptions and reduce external pressure without necessarily improving underlying ESG performance (Milne, 2002). Such behavior reflects an opportunistic response to political costs, where sustainability reporting serves as a tool for impression management rather than a transparent communication mechanism. Consequently, Positive Accounting Theory provides a useful explanation for the emergence of ESG decoupling as a strategic response to institutional and political pressures.

Legitimacy Theory

Legitimacy Theory explains how organizations seek social acceptance and continued access to resources by aligning their activities with societal values and expectations. According to Suchman (1995), organizational legitimacy represents a generalized perception that a firm's actions are appropriate within a socially constructed system of norms, values, and beliefs. Corporate survival depends not only on economic performance but also on the extent to which stakeholders perceive organizational activities as legitimate.

Sustainability reporting has become an important instrument through which firms communicate their commitment to environmental and social responsibility. Through ESG disclosure, organizations attempt to demonstrate conformity with stakeholder expectations and

strengthen their legitimacy within society (Deegan, 2002). The pursuit of legitimacy may encourage firms to increase sustainability disclosures even when actual ESG performance remains limited. Such circumstances create opportunities for symbolic reporting behavior, where organizations emphasize sustainability narratives to preserve legitimacy while avoiding substantial operational changes. Legitimacy Theory therefore provides a theoretical foundation for understanding why ESG decoupling occurs in practice.

Signaling Theory

Signaling Theory addresses information asymmetry between informed and uninformed parties. The theory proposes that organizations possessing superior quality can differentiate themselves by providing credible signals to external stakeholders (Connelly et al., 2011). In capital markets, investors frequently rely on corporate disclosures as signals of future performance, managerial quality, and organizational sustainability.

ESG disclosure serves as a non-financial signal that communicates a firm's commitment to sustainable business practices. Investors increasingly interpret ESG information as an indicator of long-term competitiveness, governance quality, and risk management capability (Eccles et al., 2014). The effectiveness of ESG disclosure as a signal depends on its credibility. When disclosed information accurately reflects actual ESG performance, investors can make more informed decisions. Conversely, discrepancies between disclosure and performance weaken signal credibility and increase information asymmetry. ESG decoupling therefore represents a failure of the signaling mechanism because stakeholders receive signals that do not accurately represent organizational reality.

Stock Price Crash Risk

Stock Price Crash Risk (SPCR) refers to the probability that a firm's stock price will experience an extreme negative decline over a relatively short period. The concept originates from the Bad News Hoarding Theory, which argues that managers often accumulate and conceal unfavorable information to avoid immediate market reactions (Kothari et al., 2009). The accumulation of undisclosed adverse information eventually becomes unsustainable, leading to a sudden release of negative news and a sharp downward correction in stock prices.

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Previous studies identify several determinants of stock price crash risk. Earnings management has been consistently associated with higher crash risk because aggressive accounting practices facilitate the concealment of unfavorable information (Francis et al., 2008). Corporate social responsibility activities may reduce crash risk by promoting transparency and stakeholder trust (Kim et al., 2014). ESG disclosure can also contribute to lower crash risk when disclosures accurately represent organizational performance and reduce information asymmetry (Habib et al., 2018). Corporate governance mechanisms such as board independence, audit quality, and institutional ownership are likewise considered important determinants because they constrain managerial opportunism and strengthen monitoring effectiveness (Callen & Fang, 2015). These findings suggest that information transparency and governance quality play critical roles in shaping stock price crash risk.

ESG Decoupling

ESG decoupling refers to the discrepancy between the sustainability information disclosed by a firm and its actual ESG performance. The concept originates from institutional theory, which distinguishes between symbolic compliance and substantive implementation (Bromley & Powell, 2012). ESG disclosure reflects how extensively a firm communicates sustainability-related information to external stakeholders, whereas ESG performance represents the actual environmental, social, and governance outcomes achieved by the organization.

Two major forms of ESG decoupling are commonly identified in the literature. The first is greenwashing, which occurs when firms disclose sustainability achievements that exceed their actual ESG performance. The second is brownwashing, which occurs when firms understate sustainability achievements despite possessing relatively strong ESG performance (Carlos & Lewis, 2018). Among these forms, greenwashing receives greater attention because it creates misleading information that may distort stakeholder perceptions and investment decisions. ESG decoupling therefore serves as an indicator of disclosure credibility and information quality within sustainability reporting.

Political Connections

Political connections refer to formal or informal relationships between firms and political actors. Firms are generally classified as politically connected when major shareholders, directors,

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commissioners, or executives maintain direct relationships with politicians, government officials, political parties, or military elites (Goldman et al., 2009). Political connections are particularly prevalent in emerging economies where institutional arrangements often facilitate close interactions between business and political interests.

In Indonesia, political connections frequently emerge through appointments of former ministers, legislators, military officers, and senior bureaucrats to boards of commissioners. Such relationships provide firms with several advantages, including privileged access to government contracts, regulatory support, and financing opportunities (Leuz & Oberholzer-Gee, 2006). Access to these resources may enhance organizational competitiveness and reduce financing constraints.

Despite these benefits, political connections may also generate governance risks. Political protection can weaken monitoring mechanisms and reduce managerial accountability. Firms may become less responsive to market discipline because political affiliations provide alternative sources of support and influence (Fan et al., 2007). The resulting information opacity increases the likelihood that managers engage in opportunistic disclosure practices while avoiding regulatory scrutiny. Consequently, political connections may amplify the negative consequences of ESG decoupling by allowing misleading sustainability disclosures to persist for longer periods.

Conceptual Framework

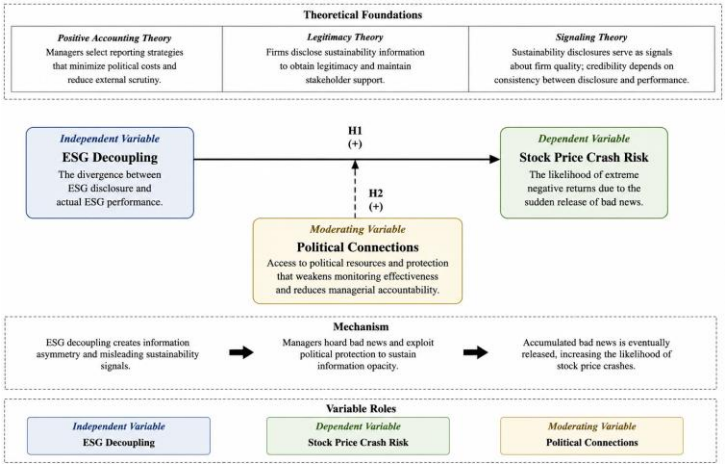

Figure 1. *Conseptual Framework*

Drawing upon Positive Accounting Theory, Legitimacy Theory, and Signaling Theory, this study proposes that ESG decoupling increases stock price crash risk through the creation of information asymmetry and misleading sustainability signals. Political connections are expected

to strengthen this relationship because political protection weakens monitoring effectiveness and allows managers to sustain information opacity. Accordingly, ESG Decoupling functions as the independent variable, Stock Price Crash Risk serves as the dependent variable, and Political Connections act as a moderating variable.

Hypothesis Development

ESG Decoupling and Stock Price Crash Risk

The divergence between ESG disclosure and ESG performance creates misleading information that may distort investors' assessments of corporate sustainability risks. Investors frequently rely on sustainability disclosures when evaluating long-term business prospects and organizational resilience. ESG decoupling causes investors to overestimate corporate quality because disclosed sustainability narratives do not accurately reflect actual operational conditions. The resulting information asymmetry enables managers to conceal unfavorable information related to environmental liabilities, governance weaknesses, and social controversies.

As hidden risks accumulate, investors continue to value firms based on incomplete information. The eventual disclosure of adverse information forces investors to rapidly revise their expectations, creating substantial downward pressure on stock prices. The Bad News Hoarding Theory predicts that such information releases increase the likelihood of stock price crashes (Kothari et al., 2009). Empirical evidence also suggests that misleading sustainability disclosures contribute to market instability and increase crash risk. Accordingly, the following hypothesis is proposed:

H1: ESG Decoupling positively affects Stock Price Crash Risk.

Moderating Role of Political Connections

Political connections may strengthen the adverse effects of ESG decoupling by reducing monitoring effectiveness and increasing managerial discretion. Firms possessing strong political affiliations often face lower regulatory pressure and enjoy greater protection from external scrutiny. Such conditions create incentives for managers to maintain misleading sustainability disclosures while delaying the revelation of unfavorable information.

Political protection extends the duration of bad news hoarding because managers perceive lower risks of regulatory sanctions and reputational penalties. The accumulation of concealed

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information consequently becomes larger and more difficult to correct gradually. Once adverse information is eventually disclosed, investors may respond with stronger negative reactions due to the greater discrepancy between expectations and reality. Political connections therefore intensify the relationship between ESG decoupling and stock price crash risk.

H2: Political Connections strengthen the positive effect of ESG Decoupling on Stock Price Crash Risk.

METHOD

Research Design

This study employs a quantitative research design to examine the effect of ESG Decoupling on Stock Price Crash Risk (SPCR) and the moderating role of Political Connections. A quantitative approach is appropriate because the study seeks to test theoretically derived hypotheses using observable firm-level data and econometric analysis (Creswell & Creswell, 2018). The study adopts a causal research design to identify whether discrepancies between ESG disclosure and actual ESG performance contribute to future stock price crash risk.

The empirical analysis is conducted using panel data consisting of firm-level observations over the period 2018–2024. Panel data provide several methodological advantages, including increased variability, improved estimation efficiency, and better control of unobservable firm-specific characteristics (Baltagi, 2021). Firm-fixed effects and year-fixed effects are incorporated to control for time-invariant firm characteristics and macroeconomic conditions that may affect stock price crash risk.

Population and Sample

The population consists of all non-financial firms listed on the Indonesia Stock Exchange (IDX) between 2018 and 2024. Financial institutions are excluded because they operate under industry-specific regulations and capital structures that differ substantially from those of non-financial firms (Chen et al., 2001).

The observation period begins in 2018 following the implementation of Financial Services Authority Regulation (POJK) No. 51/POJK.03/2017 concerning Sustainable Finance. This period

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captures the development of sustainability reporting practices after the introduction of mandatory sustainability disclosure requirements in Indonesia.

The study employs purposive sampling to ensure data completeness and consistency. Firms are included in the final sample if they satisfy the following criteria.

No.	Criteria
1	Listed as a non-financial firm on the Indonesia Stock Exchange
2	Publish Sustainability Reports during the observation period
3	Provide complete Annual Reports
4	Have available ESG Disclosure and ESG Performance data
5	Have available weekly stock return data

Table 1. *Sample Selection Criteria*

The application of these criteria ensures the availability of all variables required for empirical estimation.

Data Sources

The study relies exclusively on secondary data obtained from internationally recognized databases and official corporate disclosures.

Data Type	Source
ESG Disclosure Score	Bloomberg ESG Database
ESG Performance Score	Refinitiv Eikon
Weekly Stock Prices	Refinitiv Eikon
Annual Reports	Indonesia Stock Exchange (IDX)
Sustainability Reports	Corporate Websites and IDX
Political Connection Data	Annual Reports and Corporate Governance Reports

Table 2. *Data Sources*

Bloomberg ESG Disclosure Scores are used to measure the extent and quality of sustainability-related disclosures, while Refinitiv ESG Scores assess firms' actual environmental, social, and governance performance. Political connection data are manually collected from annual reports, ownership structures, board profiles, and corporate governance disclosures.

Variable Measurement

Stock Price Crash Risk (SPCR)

Stock Price Crash Risk serves as the dependent variable and is measured using two alternative proxies: Negative Conditional Skewness (NCSKEW) and Down-to-Up Volatility (DUVOL), following Chen et al. (2001) and Callen and Fang (2015).

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Firm-specific weekly returns are estimated using the expanded market model:

$$R_{i,t} = \alpha_i + \sum_{k=-2}^{2} \beta_k R_{m,t+k} + \varepsilon_{i,t}$$

where Ri,t represents firm returns and Rm,t represents market returns.

Weekly firm-specific returns are subsequently calculated as:

$$W_{i,t} = \ln(1 + \varepsilon_{i,t})$$

The NCSKEW measure is computed as:

$$NCSKEW = -\frac{n(n-1)^{3/2} \sum W^3}{(n-1)(n-2)(\sum W^2)^{3/2}}$$

The DUVOL measure is calculated as:

$$DUVOL = \ln\left(\frac{(n_d-1)\sum Down^2}{(n_u-1)\sum Up^2}\right)$$

Higher values of NCSKEW and DUVOL indicate greater stock price crash risk.

ESG Decoupling (ESGD)

ESG Decoupling represents the difference between ESG disclosure and actual ESG performance. Following Hawn and Ioannou (2016), both ESG Disclosure and ESG Performance scores are standardized prior to estimation.

ESG Decoupling is measured as:

$$ESGD_{i,t} = ZDisclosure_{i,t} - ZPerformance_{i,t-1}$$

Positive values indicate that firms disclose more ESG information than is reflected in their actual ESG performance, suggesting the presence of symbolic sustainability practices or greenwashing behavior.

Political Connections (POLCON)

Political Connections are measured using a dummy variable following Faccio (2006). A value of one is assigned when at least one controlling shareholder, director, or commissioner currently holds or previously held a political, governmental, legislative, military, or senior public office position. A value of zero is assigned otherwise.

Control Variables

The analysis includes several control variables that have been widely associated with stock price crash risk in prior studies.

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Variable	Symbol	Measurement
Detrended Share Turnover	DTURN	Annual change in share turnover
Return Volatility	SIGMA	Standard deviation of weekly returns
Firm-Specific Return	RET	Average weekly return
Firm Size	SIZE	Natural logarithm of total assets
Profitability	ROA	Net income divided by total assets
Leverage	LEV	Total liabilities divided by total assets
Market-to-Book Ratio	MB	Market value divided by book value

Table 3. *Control Variables*

Econometric Models

To test Hypothesis 1, the following fixed-effects regression model is estimated:

$$SPCR_{i,t+1} = \alpha + \beta_1 ESGD_{i,t} + \sum Controls_{i,t} + \varepsilon_{i,t}$$

A positive coefficient of ESGD indicates that ESG Decoupling increases Stock Price Crash Risk. To test Hypothesis 2, the moderating role of Political Connections is examined using the following interaction model:

$$SPCR_{i,t+1} = \alpha + \beta_1 ESGD + \beta_2 POLCON + \beta_3 (ESGD \times POLCON) + \sum Controls + \varepsilon$$

A positive and significant coefficient on the interaction term (β3\beta_3β3) indicates that Political Connections strengthen the effect of ESG Decoupling on Stock Price Crash Risk.

Robustness and Endogeneity Tests

Potential endogeneity may arise from omitted variables, simultaneity, and reverse causality. Firms facing elevated crash risk may alter their ESG disclosure strategies, creating a bidirectional relationship between ESG Decoupling and Stock Price Crash Risk (Wooldridge, 2020). To address these concerns, the study employs the two-step System Generalized Method of Moments (System GMM) estimator developed by Arellano and Bover (1995) and Blundell and Bond (1998). System GMM controls for dynamic endogeneity and unobserved heterogeneity by utilizing lagged explanatory variables as internal instruments. The dynamic specification is estimated as:

$$SPCR_{i,t+1} = \alpha + \rho SPCR_{i,t} + \beta_1 ESGD_{i,t} + \beta_2 POLCON_{i,t} + \beta_3 (ESGD \times POLCON)_{i,t} + \sum Controls_{i,t} + \varepsilon_{i,t}$$

Several additional robustness tests are conducted. First, ESG Decoupling is re-estimated using the absolute difference between standardized disclosure and performance scores. Second, alternative crash-risk measures are employed. Third, political connections are reclassified using

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board-level political affiliations only. Finally, industry and period sensitivity analyses are performed to ensure that the results are not driven by specific sectors or regulatory events. The consistency of results across these alternative specifications would provide additional evidence regarding the validity and reliability of the study's findings.

RESULTS AND DISCUSSION

Result

Sample Selection

Table 4 presents the sample selection process. The initial population consisted of all non-financial firms listed on the Indonesia Stock Exchange (IDX) between 2018 and 2024. Firms without Sustainability Reports, ESG data, or weekly stock return information were excluded from the sample. The final sample comprises 142 firms, resulting in 994 firm-year observations.

Sample Selection Process	Firms
Non-financial firms listed on IDX	703
Less: Firms without Sustainability Reports	(281)
Less: Firms without ESG Disclosure and ESG Performance data	(198)
Less: Firms without weekly stock return data	(82)
Final Sample Firms	142
Observation Period	2018–2024
Firm-Year Observations	994

Table 4. *Sample Selection Procedure*

Descriptive Statistics

Table 5 reports descriptive statistics for all variables. The average ESG Decoupling score is 0.284, suggesting that ESG disclosure generally exceeds actual ESG performance. The mean value of Political Connections is 0.412, indicating that approximately 41.2% of firms maintain political affiliations. The average values of NCSKEW and DUVOL suggest substantial variation in crash risk across firms.

Variable	Mean	Median	Std. Dev.	Min	Max
NCSKEW	-0.312	-0.295	0.721	-2.184	1.921
DUVOL	-0.198	-0.174	0.476	-1.235	1.298
ESGD	0.284	0.267	0.798	-1.512	2.563
POLCON	0.412	0.000	0.492	0.000	1.000
DTURN	0.428	0.251	1.263	-3.405	10.521
SIGMA	0.056	0.052	0.022	0.011	0.168

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Variable	Mean	Median	Std. Dev.	Min	Max
RET	-0.039	-0.024	0.148	-0.672	0.463
SIZE	29.765	29.611	1.537	26.214	33.591
ROA	0.052	0.046	0.074	-0.241	0.368
LEV	0.448	0.436	0.191	0.047	0.884
MB	1.914	1.403	1.705	0.198	8.763

***Table 5**. Descriptive Statistics*

Correlation Analysis

Table 6 presents the Pearson correlation matrix. ESG Decoupling is positively correlated with both stock price crash risk proxies, providing preliminary evidence of a positive association between ESG Decoupling and future crash risk. The correlations among explanatory variables remain relatively low.

Variables	ESGD	POLCON	DTURN	SIGMA	SIZE	ROA
ESGD	1.000					
POLCON	0.118	1.000				
DTURN	0.091	0.067	1.000			
SIGMA	0.164	0.052	0.135	1.000		
SIZE	0.203	0.281	-0.054	0.033	1.000	
ROA	-0.095	-0.021	0.018	-0.087	0.213	1.000

***Table 6.** Pearson Correlation Matrix*

Multicollinearity Test

Variance Inflation Factor (VIF) statistics are reported in Table 7. The highest VIF value is 1.57, which is substantially below the threshold value of 10. The results indicate that multicollinearity is not a concern.

Variable	VIF
ESGD	1.34
POLCON	1.28
DTURN	1.15
SIGMA	1.22
RET	1.10
SIZE	1.57
ROA	1.39
LEV	1.46
MB	1.21
Mean VIF = 1.30	

***Table 7.** Variance Inflation Factors*

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Main Regression Results

Table 8 presents the fixed-effects regression results. ESG Decoupling exhibits a positive and statistically significant coefficient across both NCSKEW and DUVOL specifications.

Variables	NCSKEW	DUVOL
ESGD	0.148***	0.097***
	(3.28)	(3.12)
DTURN	0.041*	0.028*
SIGMA	2.134**	1.876**
RET	0.148	0.091
SIZE	0.054**	0.035*
ROA	-0.331	-0.214
LEV	0.274**	0.186*
MB	0.048*	0.031*
Firm FE	Yes	Yes
Year FE	Yes	Yes
Observations	994	994
Adj. R^2	0.162	0.146

Table 8. *Main Regression Results*
*Notes: *, **, and *** indicate significance at the 10%, 5%, and 1% levels.*

The coefficient of ESGD remains positive and significant, indicating that firms with higher ESG Decoupling experience greater stock price crash risk.

Moderation Analysis

Variables	NCSKEW	DUVOL
ESGD	0.082**	0.055**
POLCON	-0.121*	-0.087*
ESGD × POLCON	0.129**	0.091**
Controls	Yes	Yes
Firm FE	Yes	Yes
Year FE	Yes	Yes
Observations	994	994
Adj. R^2	0.187	0.171

Table 9. *Moderating Effect of Political Connections*

The interaction term is positive and statistically significant, indicating that Political Connections strengthen the positive association between ESG Decoupling and Stock Price Crash Risk.

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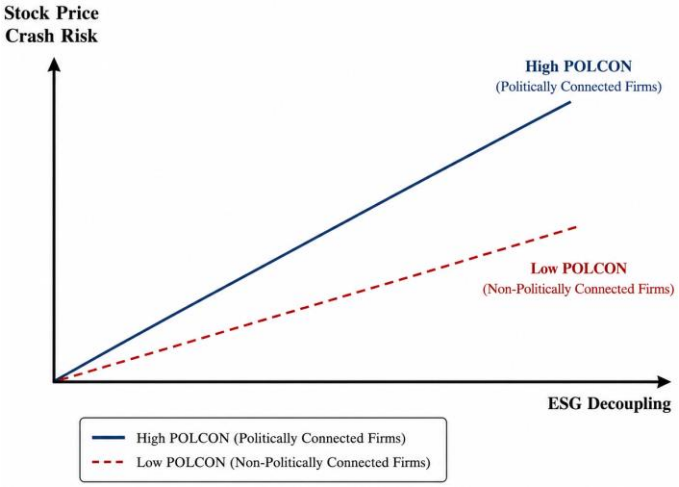

Figure 2. Moderating Effect of Political Connections

Robustness and Endogeneity Analysis

Table 10 reports the results of the two-step System GMM estimation used to address potential endogeneity concerns.

Variables	System GMM
ESGD	0.136***
POLCON	-0.097*
ESGD × POLCON	0.118**
Lagged SPCR	0.287***
AR(1) p-value	0.021
AR(2) p-value	0.287
Hansen p-value	0.462

Table 10. *System GMM Results*

The insignificant AR(2) statistic indicates the absence of second-order serial correlation, while the Hansen test confirms the validity of the instruments. Additional robustness tests using alternative ESG Decoupling measures and alternative stock price crash risk proxies yield qualitatively similar results. The coefficients remain positive and statistically significant, indicating that the empirical findings are robust to alternative specifications.

Hypothesis	Prediction	Result	Decision
H1	ESGD → SPCR (+)	Positive and Significant	Supported
H2	ESGD × POLCON → SPCR (+)	Positive and Significant	Supported

Table 11. *Summary of Hypothesis Testing*

The results consistently support the argument that ESG Decoupling increases Stock Price Crash Risk and that Political Connections amplify this effect

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Discussion

ESG Decoupling and Stock Price Crash Risk

The empirical results indicate that ESG Decoupling has a positive and statistically significant effect on Stock Price Crash Risk, supporting Hypothesis 1. The findings suggest that firms exhibiting a greater discrepancy between ESG disclosure and actual ESG performance are more likely to experience future stock price crashes. This evidence indicates that sustainability disclosures that are not supported by substantive ESG practices create an information environment characterized by greater opacity and reduced disclosure credibility.

The observed relationship is consistent with the Bad News Hoarding Theory. Managers possess incentives to withhold unfavorable information when disclosure may negatively affect firm value, managerial reputation, or compensation (Jin & Myers, 2006). ESG Decoupling provides an additional mechanism through which negative information can remain concealed. Firms may present extensive sustainability disclosures while underlying environmental, social, and governance weaknesses remain unresolved. The accumulation of undisclosed adverse information increases information asymmetry between managers and investors. Once such information becomes publicly available, investors revise their expectations simultaneously, generating substantial downward pressure on stock prices and increasing crash risk.

The findings are also consistent with Signaling Theory. Corporate disclosures function as signals that assist investors in evaluating firm quality under conditions of information asymmetry (Spence, 1973). ESG disclosures are expected to communicate a firm's commitment to sustainability, responsible governance, and long-term value creation. Signal effectiveness depends on credibility. A significant divergence between disclosure and actual performance weakens the informational value of ESG reporting. Investors relying on sustainability disclosures may overestimate organizational quality and underestimate firm-specific risks. The correction of these misperceptions contributes to higher stock price crash risk.

The results reinforce the growing literature on greenwashing. Greenwashing occurs when firms strategically communicate positive sustainability narratives that are not supported by corresponding operational practices (Delmas & Burbano, 2011). ESG Decoupling represents a measurable manifestation of such behavior because firms disclose sustainability achievements that

exceed their actual ESG performance. These practices may improve corporate reputation in the short term while simultaneously increasing information opacity. The market eventually recognizes inconsistencies between disclosure and performance, resulting in a reassessment of firm value and a greater probability of stock price crashes.

The Indonesian context provides additional insight into this relationship. The implementation of POJK No. 51/POJK.03/2017 has increased sustainability reporting requirements among listed firms. Regulatory pressure to disclose sustainability information may encourage some firms to emphasize reporting compliance rather than substantive ESG improvements. Under these circumstances, sustainability reports may function primarily as legitimacy-building instruments rather than accurate representations of organizational performance. Such conditions increase the likelihood of ESG Decoupling and its associated crash-risk consequences.

The findings extend prior research examining ESG-related determinants of stock price crash risk. Previous studies have documented that credible corporate social responsibility practices reduce crash risk through enhanced transparency and reduced managerial opportunism (Kim et al., 2014). The present study demonstrates that discrepancies between ESG disclosure and ESG performance generate the opposite effect. The evidence suggests that disclosure credibility constitutes a critical determinant of market stability.

Moderating Effect of Political Connections

The empirical evidence indicates that Political Connections strengthen the positive relationship between ESG Decoupling and Stock Price Crash Risk. The positive and significant interaction coefficient suggests that the adverse consequences of ESG Decoupling become more pronounced among politically connected firms. The findings provide support for Hypothesis 2.

The Political Cost Hypothesis offers an explanation for this result. Positive Accounting Theory argues that managers select reporting strategies that minimize political costs and external scrutiny (Watts & Zimmerman, 1986). Political affiliations provide firms with access to influential policymakers, regulators, and government institutions. Such relationships may reduce regulatory pressure and weaken the effectiveness of external monitoring mechanisms. Managers operating within politically connected firms may therefore possess greater discretion to maintain

discrepancies between sustainability disclosure and actual ESG performance. Reduced oversight allows ESG Decoupling practices to persist for longer periods, increasing the accumulation of hidden risks.

Agency Theory provides an additional explanation for the observed moderating effect. Agency conflicts emerge when managerial interests diverge from shareholder interests (Jensen & Meckling, 1976). Political protection may weaken governance effectiveness by reducing accountability and limiting stakeholder monitoring. Managers may exploit political affiliations to pursue symbolic disclosure strategies while concealing unfavorable information regarding ESG performance. The resulting increase in information opacity contributes to the accumulation of undisclosed risks that ultimately intensify stock price crashes.

Resource Dependence Theory further explains why political connections amplify the adverse effects of ESG Decoupling. Organizations establish external relationships to secure resources necessary for survival and growth (Pfeffer & Salancik, 1978). Political connections provide access to government contracts, financing opportunities, regulatory support, and strategic information (Faccio, 2006). These advantages can reduce firms' dependence on market-based legitimacy and transparency. Managers may consequently perceive less pressure to maintain high-quality sustainability disclosures because political networks provide alternative sources of organizational support. Reduced transparency strengthens the negative market consequences associated with ESG Decoupling.

The Indonesian institutional environment is particularly relevant in this context. Political affiliations frequently occur through the appointment of former ministers, legislators, military officers, and senior bureaucrats as commissioners or directors (Harymawan et al., 2019). Such affiliations may create informal protection mechanisms that reduce scrutiny from external stakeholders. The findings suggest that political connections not only affect resource access but also influence the credibility and informational quality of sustainability disclosures.

The results imply that investors should exercise greater caution when evaluating ESG disclosures issued by politically connected firms. Strong sustainability narratives may not necessarily reflect actual ESG performance when political affiliations reduce the effectiveness of monitoring mechanisms. Regulatory authorities may also need to strengthen independent

verification of sustainability disclosures to reduce information asymmetry and improve market transparency.

Comparison with Previous Studies

The findings align with recent evidence reported by Hussain et al. (2025), who documented that ESG Decoupling increases Stock Price Crash Risk because discrepancies between sustainability disclosure and actual ESG performance create informational distortions that mislead investors. The present study extends this evidence by demonstrating that the relationship remains significant in an emerging-market setting characterized by concentrated ownership structures and extensive political involvement in corporate governance.

The results complement the findings of Kim et al. (2014), who reported that genuine corporate social responsibility activities reduce stock price crash risk by enhancing transparency and limiting managerial incentives to conceal unfavorable information. The current study examines the opposite condition, namely the divergence between sustainability disclosure and sustainability performance. The evidence suggests that sustainability reporting contributes to market stability only when disclosure accurately reflects underlying organizational practices.

The moderating role of Political Connections is consistent with the findings of Harymawan et al. (2019), who documented that politically connected firms exhibit higher stock price crash risk due to weaker monitoring mechanisms and greater information opacity. The present study identifies ESG Decoupling as a specific channel through which political connections contribute to crash risk. Political affiliations appear to facilitate the persistence of misleading sustainability disclosures, increasing the volume of concealed information and intensifying future market corrections.

The findings contribute to the growing literature on sustainability reporting and capital market outcomes by emphasizing the importance of disclosure credibility. Investors appear to evaluate not only the quantity of sustainability information but also its consistency with actual organizational performance. Institutional characteristics such as political connections influence the extent to which ESG disclosures provide reliable information to the market.

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CONCLUSION

This study examines the relationship between ESG Decoupling and Stock Price Crash Risk and investigates whether Political Connections strengthen this relationship among non-financial firms listed on the Indonesia Stock Exchange. The findings reveal that ESG Decoupling significantly increases future stock price crash risk. Firms that disclose sustainability information exceeding their actual ESG performance create a misleading information environment that obscures underlying risks and weakens disclosure credibility. Such conditions facilitate the accumulation of undisclosed adverse information and increase the likelihood of abrupt downward corrections in stock prices when hidden information eventually reaches the market. The findings support the predictions of the Bad News Hoarding Theory and Signaling Theory, suggesting that the effectiveness of ESG disclosure depends not only on the quantity of information provided but also on its consistency with substantive organizational practices. The evidence also extends the growing literature on greenwashing by demonstrating that discrepancies between sustainability narratives and actual ESG outcomes represent an important source of capital market risk.

The study further demonstrates that Political Connections strengthen the positive effect of ESG Decoupling on Stock Price Crash Risk. Political affiliations appear to weaken monitoring effectiveness, reduce managerial accountability, and prolong the persistence of information opacity. The results suggest that politically connected firms are more capable of maintaining symbolic sustainability disclosures while delaying the disclosure of unfavorable information. These findings contribute to Positive Accounting Theory, particularly the Political Cost Hypothesis, by illustrating how political influence interacts with sustainability reporting practices to shape market outcomes. From a practical perspective, the results provide important implications for regulators, investors, and corporate stakeholders. Regulatory authorities should strengthen sustainability assurance mechanisms and improve the verification of ESG disclosures to reduce the risk of misleading reporting practices. Investors should evaluate the alignment between ESG disclosure and actual ESG performance rather than relying solely on reported sustainability information. Future studies may extend this research by examining alternative institutional settings, exploring specific ESG dimensions, and investigating whether external assurance or

board characteristics can mitigate the adverse consequences of ESG Decoupling on market stability.

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