

The Green Paradox: Examining the Mediating Role of Dynamic Capabilities in the Relationship between ESG Performance and Long-term Firm Value in Emerging Markets

Seandy Ginanjar¹, Setiawan Sariyoga², Andi³

^{1,2,3}Universitas Sultan Ageng Tirtayasa, Indonesia

Email: seandy4@untirta.ac.id^{1,2}, andiplg69@untirta.ac.id²

Correspondence Authors: seandy4@untirta.ac.id

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ABSTRACT

This study investigates how dynamic capabilities mediate the relationship between environmental, social, and governance (ESG) performance and long-term firm value in emerging markets, where institutional volatility, regulatory gaps, and resource constraints create unique implementation challenges. Drawing on qualitative evidence from multiple case studies of listed and large private firms in selected Asian and African emerging economies, this study explores how firms translate ESG performance into enduring value through sensing, seizing, and reconfiguring capabilities. Semi-structured interviews with senior managers, sustainability officers, and investors were combined with document analysis of ESG reports, corporate disclosures, and regulatory guidelines to construct a comprehensive narrative of ESG–capability–value linkages. The findings indicate that ESG performance alone does not guarantee long-term value; instead, value creation depends on firms' ability to develop absorptive, adaptive, and integrative dynamic capabilities that align ESG initiatives with core strategy, innovation, and stakeholders' expectations. The study further uncovers a "green paradox" whereby superficial or poorly aligned ESG initiatives may increase short-term visibility and market valuation but erode dynamic capabilities, ultimately undermining long-term value. These insights enrich the ESG and strategic management literatures and provide implications for managers, regulators, and investors seeking to avoid capability-depleting forms of ESG engagement in emerging markets.

Keywords: Green Paradox, Mediating, Dynamic

INTRODUCTION

Over the past decade, ESG performance has become a central criterion for assessing corporate legitimacy, risk exposure, and investment attractiveness, including in emerging markets. Governments, regulators, and stock exchanges in Asia, Africa, the Middle East, and Latin America have progressively encouraged or mandated ESG disclosure, reflecting a broader global shift towards sustainable finance and stakeholder capitalism. Simultaneously, institutional voids, weak enforcement, and heterogeneous stakeholder expectations in emerging economies create conditions under which ESG adoption can be both a source of innovation and a vehicle for symbolic compliance or greenwashing. These contextual characteristics raise fundamental questions about how ESG performance translates into firm value in such environments over the long term in such environments (Zheng et al., 2025).

Existing empirical research generally reports that higher ESG performance is associated with enhanced firm value through mechanisms such as improved reputation, reduced financing costs, stronger stakeholder loyalty, and improved risk management. However, these studies also reveal substantial heterogeneity and non-linearity in the relationship, including evidence of diminishing returns, inverted U-shaped patterns, and negative effects when ESG initiatives are excessive, misaligned or opportunistic. In particular, greenwashing practices—where firms overstate their environmental or social achievements—have been shown to generate short-term valuation gains by relaxing financing constraints while ultimately damaging credibility, innovation capacity, and long-run value. This dual effect echoes a broader "ESG paradox" or "sustainability–productivity paradox," in which formal sustainability metrics improve while underlying competitiveness and value-creation capabilities deteriorate (Farhana et al., 2025).

Dynamic capabilities theory offers a promising lens to unpack this paradox and explain why ESG performance sometimes supports and at other times undermines long-term firm value. Dynamic capabilities refer to a firm's ability to sense opportunities and threats, seize them through appropriate investments and

business model adjustments, and reconfigure its asset base to sustain a competitive advantage in changing environments. Recent studies link absorptive and adaptive capabilities to the effective implementation of ESG strategies and sustainable performance, suggesting that ESG initiatives become value-enhancing when they are embedded in coherent capability-building processes rather than treated as stand-alone compliance activities. In this sense, dynamic capabilities can be conceptualized as the missing mechanism that conditions the transformation of ESG performance into enduring firm value (Akhtar et al., 2020).

Despite this theoretical potential, existing ESG research in emerging markets is dominated by quantitative designs that estimate direct associations between ESG scores or disclosures and financial performance, often using panel regressions on stock exchange data. While valuable, such approaches typically treat dynamic capabilities as unobserved factors and rarely offer granular insights into how managers interpret ESG demands, design strategies, and reconfigure organizational processes in practice. Furthermore, prior work tends to focus on sustainability performance or short- to medium-term financial outcomes, with less attention to the longer time horizons over which capability accumulation, stakeholder trust, and innovation trajectories shape firm values. Therefore, there is a need for qualitative, process-oriented research that traces the complex pathways from ESG engagement through capability development to long-term value in specific institutional contexts (Simanjuntak et al., 2026).

Emerging markets are particularly salient settings for such inquiries because firms operate under conditions of institutional flux, regulatory ambiguity, and resource scarcity, which amplify both the risks and opportunities associated with ESG strategies. On the one hand, nascent ESG ecosystems may permit symbolic compliance, fragmented reporting, and selective implementation, thereby enabling greenwashing and surface-level reputational gains without substantive capability improvement. However, latecomer status and looser legacy constraints may allow firms to leapfrog towards more sustainable technologies and governance practices if they can develop the requisite dynamic capabilities to integrate ESG into their strategic core. The tension between these trajectories lies at the heart of what this article labels the "green paradox" in emerging markets: firms that appear to excel in ESG performance according to external metrics may, in fact, undermine the dynamic capabilities needed for long-term value creation (F. & J., 2026).

This study addresses these gaps by examining the mediating role of dynamic capabilities in the ESG–long-term firm value relationship through an in-depth qualitative study of firms from selected emerging markets in Asia and Africa, including sectors such as manufacturing, natural resources, financial services, and consumer goods. This study adopts a dynamic capabilities perspective to explore how ESG performance interacts with absorptive, adaptive, and integrative capabilities and how these interactions shape the trajectories of value creation or erosion over an extended horizon. The focus on long-term firm value encompasses not only conventional financial indicators such as sustained profitability, market valuation, and cost of capital, but also more strategic outcomes, including innovation pathways, stakeholder trust, and resilience to shocks.

From a theoretical perspective, this study contributes to three streams of literature. First, it advances ESG research by moving beyond direct effect models to conceptualize ESG performance as an input into capability-building processes, rather than an outcome in itself. Second, it deepens the understanding of dynamic capabilities in emerging markets by revealing how institutional weaknesses, regulatory experimentation, and social expectations shape ESG capability development. Third, it refines the notion of the green paradox by demonstrating that paradoxical outcomes often arise not from ESG per se, but from misaligned ESG–capability configurations that prioritize symbolic visibility over learning, experimentation, and reconfiguration.

From a practical perspective, the findings offer guidance for managers seeking to design ESG strategies that genuinely enhance long-term value, rather than simply meeting disclosure requirements or attracting short-term investor attention. The analysis highlights the importance of investing in organizational learning mechanisms, cross-functional integration, and stakeholder engagement processes that transform ESG activities into dynamic capabilities for continuous adaptation. For policymakers and regulators, this study underscores the need to complement disclosure rules with frameworks that incentivize capability-building, discourage greenwashing, and recognize context-specific pathways to sustainable competitiveness in emerging markets.

The remainder of this paper is structured as follows. The next section reviews the relevant literature on ESG performance, long-term firm value, dynamic capabilities and the green paradox in emerging markets. This is followed by a detailed description of the qualitative research design, including the case selection, data collection, and analysis procedures. The subsequent section presents the empirical findings, organized around key themes and supported by qualitative tables summarizing the patterns across the cases. The discussion section interprets these findings in light of existing theory, elaborates on the green paradox mechanism, and outlines implications for research and practice. The article concludes by summarizing the main contributions, acknowledging the limitations, and suggesting directions for future research.

LITERATURE REVIEW

ESG performance and long-term firm value

ESG performance refers to a firm's observable practices, policies, and outcomes related to environmental stewardship, social responsibility, and governance quality, as captured by ratings agencies, sustainability reports, or regulatory disclosures. A broad stream of empirical studies across developed and emerging markets shows that firms with stronger ESG performance tend to enjoy higher firm value, often measured using metrics such as Tobin's Q, market capitalization, or price-to-book ratios. This positive association is typically attributed to mechanisms, including enhanced reputation and brand equity, greater access to capital, lower cost of debt, improved risk management, and closer alignment with long-term institutional investors.

However, the ESG–firm value relationship is neither universal nor strictly linear. Some studies have identified negligible or even negative effects when ESG investments generate significant costs without corresponding revenue gains or risk reductions, particularly in resource-intensive or highly competitive industries. Other studies find evidence of an inverted U-shaped relationship, whereby moderate ESG engagement enhances value, but excessive spending or poorly targeted initiatives leads to diminishing returns or resource misallocation. In emerging markets, where financial constraints, data quality issues, and institutional volatility are more pronounced, these trade-offs can be particularly acute.

Recent studies have also highlighted the temporal dimension of ESG value creation. Greenwashing-focused studies show that exaggerated ESG claims or symbolic disclosures can temporarily boost firm value by easing financing constraints and attracting investor interest but eventually result in valuation corrections once information asymmetries narrow and reputational penalties materialize. In contrast, genuinely embedded ESG strategies may show modest short-term financial impacts but generate significant long-term benefits by building stakeholder trust, innovation capabilities, and resilience to shocks such as regulatory changes or climate-related disruptions (Syarifuddin et al., 2025).

Dynamic capabilities and sustainable performance

Dynamic capabilities theory explains how firms achieve and sustain competitive advantages by continuously sensing environmental changes, seizing opportunities through investments and strategic initiatives, and reconfiguring their resource bases and organizational structures. In the sustainability domain, absorptive capability—the ability to recognize, assimilate, and apply external knowledge—enables firms to learn about evolving ESG standards, technologies, and stakeholder expectations. Adaptive capability allows firms to adjust their routines, processes, and business models in response to environmental and social risks, whereas integrative or reconfiguring capabilities support the alignment of ESG objectives with core operations and governance systems.

Empirical research indicates that dynamic capabilities are positively associated with sustainable performance, including financial and non-financial outcomes. For example, studies in the Korean and Chinese contexts find that absorptive and adaptive capabilities indirectly enhance sustainable management performance by enabling the effective implementation of ESG strategies. Other studies on emerging-market SMEs show that market and learning orientations underpin the development of dynamic capabilities that allow firms to respond flexibly to institutional uncertainties and competitive pressures. Collectively, these studies suggest that ESG outcomes and dynamic capabilities are mutually reinforcing when capability-building is integrated into sustainability initiatives (Ayoub & Sopuru, 2026).

However, the literature also recognizes that dynamic capabilities are not automatically beneficial. Capability development requires significant investments in learning, experimentation, and organizational redesign, which may strain the limited resources of emerging markets. Furthermore, if ESG initiatives are pursued primarily for signaling purposes, firms may invest in visible but shallow activities that do little to enhance their sensing, seizing, or reconfiguring capacities. In such cases, ESG programs may divert managerial attention and resources away from deeper capability-building efforts, thereby undermining the company's long-term competitiveness.

ESG, dynamic capabilities, and the green paradox

The concept of a "green paradox" in this study refers to situations where rising ESG performance metrics coexist with weakening long-term value creation capabilities. Prior research on the sustainability–productivity paradox notes that organizations can exhibit impressive sustainability disclosures and certifications while experiencing stagnating productivity or innovation, partly because their efforts remain decoupled from core operational and strategic processes. In the ESG domain, greenwashing studies document how superficial sustainability communication may generate short-lived valuation premiums that

are reversed over time as stakeholders update their beliefs and discount unreliable signals.

Dynamic capabilities provide a mechanism-based explanation for this. When ESG engagement is tightly coupled with sensing and learning routines, opportunity evaluation, and resource reconfiguration, it contributes to the renewal of business models and competitive advantages. For instance, firms that use ESG initiatives to experiment with low-carbon technologies, inclusive employment models, or new governance practices often strengthen their adaptive capabilities and obtain first-mover advantages in emerging regulatory frameworks. Conversely, when ESG is treated as a peripheral reporting exercise or marketing tool, the underlying dynamic capabilities may remain underdeveloped or even deteriorate, especially if managerial attention is diverted towards metrics rather than experimentation and learning (M. Gomathy, 2025).

In emerging markets, the risk of such decoupling is heightened by weaker enforcement, less sophisticated investor bases in some segments, and significant data asymmetries between firms and their stakeholders. These conditions create incentives for firms to prioritize visible ESG indicators and disclosure templates that satisfy regulators and external rating agencies while postponing or neglecting the deeper organizational transformations required for sustainable value creation. Consequently, firms may simultaneously improve their ESG scores and increase their vulnerability to future shocks, regulatory tightening, or shifts in investor sentiment, which is—a manifestation of the green paradox.

ESG and firm value in emerging markets

ESG research in emerging markets shows that ESG performance can enhance firm value, but the outcomes are strongly conditioned by sectoral characteristics, institutional quality, and governance practices. Sector-level analyses indicate that social and governance pillars often exert a stronger influence on overall ESG scores and perceived sustainability than environmental metrics, reflecting stakeholders' concerns regarding labor practices, community engagement, and internal control in these contexts. Studies have also found that governance-related ESG practices—such as board independence, shareholder rights, and disclosure quality—are particularly salient drivers of valuation in markets where investor protection and legal enforcement are evolving.

At the same time, heterogeneity across firm ownership, size, and internationalization is evident. For example, research on Chinese listed firms suggests that non-state-owned enterprises may enjoy stronger short-term valuation gains from ESG-related communication or greenwashing than state-owned firms, although long-term penalties converge once misrepresentation is revealed. Other studies have shown that firms with better ESG performance in emerging markets attract more stable foreign investment and exhibit greater resilience during periods of volatility, provided that ESG initiatives are substantively integrated into operations (Syarkani et al., 2024).

Despite these insights, the mediating role of dynamic capabilities in the ESG–firm value linkage in emerging markets is underexplored. While some studies implicitly acknowledge capability-related mechanisms, —such as organizational visibility, innovation, and risk management, —few explicitly conceptualize and empirically examine dynamic capabilities as mediators. This study addresses this gap through a qualitative design that foregrounds managerial interpretations, capability-building processes, and context-specific constraints, thereby complementing and extending existing quantitative findings (Siddiqui et al., 2024).

RESEARCH METHOD

Research design

This study employs a qualitative multiple-case study design to explore how dynamic capabilities mediate the relationship between ESG performance and long-term firm value in emerging markets. The choice of a qualitative design is motivated by the need to understand the complex, context-dependent processes of interpretation, learning, and capability development that are not easily captured by quantitative indicators alone. A multiple-case approach enables a systematic comparison across firms, industries, and country contexts while preserving the depth required to trace ESG–capability–value linkages over time (Sugiyono, 2019).

This research follows an abductive logic, iterating between existing theoretical constructs from ESG and dynamic capabilities literature and emerging empirical insights from case data. Initial sensitizing concepts—such as absorptive capability, adaptive capability, reconfiguration, and greenwashing—were derived from prior studies but were refined and extended through engagement with field evidence. This iterative movement allows for the identification of nuanced patterns in how ESG performance interacts with dynamic capabilities to shape long-term firm value.

Case selection

Cases were selected using purposive theoretical sampling to maximize variation along three dimensions: ESG performance level, perceived long-term value trajectory, and institutional context. First, firms that displayed relatively high or improving ESG performance, as indicated by third-party ESG scores, sustainability awards, or inclusion in responsible investment indexes, were chosen, ensuring that ESG engagement was sufficiently salient. Second, variation in long-term value trajectories was sought by including firms with sustained value growth, flat performance, or significant value erosion over a 5–10-year horizon, based on publicly available financial and market data. Third, firms from different emerging-market regions (for example, Southeast Asia and Sub-Saharan Africa) and sectors (such as energy, manufacturing, finance, and consumer goods) were included to capture contextual diversity in institutional frameworks, regulatory regimes, and stakeholder expectations.

The final sample comprised 12 firms: seven publicly listed and five large private or state-owned enterprises. All firms operated in countries classified as emerging markets by major financial institutions and stock indices. Most were regional or domestic market leaders and were subject to ESG disclosure guidelines issued by local regulators and stock exchanges. This sample allowed for the exploration of both convergent and divergent patterns in ESG–capability–value dynamics across contexts.

Data collection

Data collection combined semi-structured interviews with document analysis to construct rich narrative case studies. Semi-structured interviews were conducted with 36 informants across the 12 firms, including senior managers (e.g., chief executive officers and chief financial officers), sustainability or ESG officers, risk managers, and investor relations personnel. Where possible, interviews were also held with external stakeholders such as institutional investors, analysts, and regulators familiar with the focal firms' ESG practices. The interview protocol covered themes such as the history and drivers of ESG engagement, design and implementation of ESG strategies, organizational changes associated with ESG initiatives, perceptions of their impact on competitiveness and value, and views on regulatory and market pressures (Creswell, 2021).

In parallel, extensive document analysis was undertaken, focusing on ESG and sustainability reports, annual reports, corporate governance codes, integrated reports, and relevant regulatory guidelines or stock exchange rules in the respective countries. External ESG ratings, press coverage, and analyst reports were also examined, where available, providing additional perspectives on firms' ESG performance and value trajectories. The combination of interviews and documents enhanced data triangulation and reduced the risk of relying solely on self-reported accounts of the participants.

All interviews were audio-recorded with consent and transcribed, verbatim. Document data were imported alongside the interview transcripts into a qualitative analysis software package to facilitate coding, retrieval, and comparison. Data collection continued until thematic saturation was reached, meaning that additional interviews or documents yielded diminishing insights regarding the ESG–capability–value relationships.

Data analysis

Data analysis followed a multi-stage, inductive–deductive process. In the first stage, open coding was applied to the interview transcripts and documents to identify descriptive categories related to ESG initiatives, capability-building activities, stakeholder relations, governance changes, and perceived value outcomes. The codes were initially kept close to the informants' language to preserve contextual richness.

In the second stage, axial coding was used to group first-order codes into broader themes that were related more explicitly to dynamic capability constructs (for example, sensing, absorptive capacity, adaptive capability, and reconfiguring) and to dimensions of long-term firm value (for example, sustained profitability, innovation, resilience, and stakeholder trust). This step involved constant comparison within and across cases to identify similarities and differences in how ESG performance is linked to capability development and value outcomes.

In the third stage, selective coding focused on refining the core theoretical categories and their relationships. Particular attention was paid to the mechanisms through which ESG initiatives either enhanced or eroded dynamic capabilities and how these mechanisms, in turn, supported or undermined long-term value. Cross-case matrices and qualitative tables were constructed to map the patterns of ESG engagement, capability profiles, and value trajectories, which are presented in the Results section.

Analytical rigor was strengthened using several strategies. First, multiple researchers participated in

coding a subset of cases and reconciled discrepancies through discussion, thereby improving reliability. Second, emerging interpretations were periodically shared with selected informants for feedback, enhancing credibility and reducing the risk of misinterpretation. Third, negative cases—firms whose experiences deviated from dominant patterns—were actively sought and incorporated into the analysis to refine the emerging explanations (Miles, M. B., & Huberman, 2014).

RESULTS AND DISCUSSIONS

The 12 cases exhibited diverse ESG profiles, dynamic capability configurations, and long-term value trajectories. Table 1 summarizes the key features across cases using anonymized labels.

Table 1. Summary of ESG performance, dynamic capabilities, and long-term value trajectories across cases

Case	Sector	ESG performance (relative)	Dynamic capabilities profile	Long-term firm value trajectory (10-year view)
A1	Energy	High and improving	Strong absorptive and adaptive, moderate reconfiguring	Sustained growth in profitability and market valuation
A2	Manufacturing	Moderate, uneven	Developing absorptive, weak adaptive and reconfiguring	Flat value with periods of volatility
A3	Financial services	High disclosure, moderate substance	Strong sensing, uneven reconfiguring	Initial value surge followed by stabilization
A4	Consumer goods	Moderate but authentic	Balanced capabilities, strong stakeholder integration	Gradual but robust value growth
A5	Natural resources	High on paper, suspected greenwashing	Limited absorptive, weak adaptive	Short-term valuation spike, subsequent decline
A6	Infrastructure	Low to moderate, nascent	Emerging capabilities, strong entrepreneurial orientation	Improving value from low base
B1	Energy	Moderate, compliance-driven	Operational focus, limited strategic reconfiguration	Stagnant value, vulnerability to shocks
B2	Manufacturing	High ESG linked to innovation	Strong absorptive and reconfiguring	Strong long-term value growth
B3	Financial services	Governance-focused ESG	Strong governance and risk-related capabilities	Stable, resilient value with moderate growth
B4	Consumer goods	Social pillar emphasis	Strong stakeholder engagement capabilities	Resilient value, reputation-driven advantages
B5	Natural resources	Patchy ESG, regulatory pressure	Reactive capabilities, project-based learning	Fluctuating value tied to commodity cycles

Case	Sector	ESG performance (relative)	Dynamic capabilities profile	Long-term firm value trajectory (10-year view)
B6	Mixed utilities	Improving ESG from low base	Growing sensing and adaptive capabilities	Early signs of value recovery

This table is based on interpretive assessments derived from interviews, ESG reports, and financial and market information rather than standardized ESG scores or quantitative metrics. This highlights that high or improving ESG performance does not uniformly translate into strong long-term value; rather, patterns of dynamic capability development appear to differentiate firms with similar ESG profiles.

Two broad patterns emerged across the cases: ESG-driven capability building and symbolic or compliance-oriented ESG. In firms such as A1, A2 (later stages), B2, and B4, ESG initiatives were explicitly framed as vehicles of learning, innovation, and strategic renewal. Senior managers in these firms described ESG as "a lens through which we rethink our entire business model" or "a catalyst for cross-functional collaboration" rather than as a reporting obligation. ESG projects in these firms often involve experimentation with new technologies (for example, energy efficiency and circular economy models), new employment and community programs, and new governance practices that require building new routines and skills.

In contrast, firms such as A5, B1, and B5 engaged in what informants sometimes described as "tick-box" or "branding" ESG. Here, ESG efforts are centered on producing polished sustainability reports, meeting minimum disclosure requirements, or obtaining visible certifications with limited internal transformation. Middle managers in these firms frequently reported that ESG activities were "added on" to existing processes and that operational and commercial teams were only marginally involved in them. While ESG scores or external ratings for these firms were often comparable to or even higher than those of more capability-oriented peers, their internal narratives revealed weak integration with strategic decision-making and limited learning or adaptation.

Table 2. Patterns of ESG engagement and dynamic capability development

Pattern	Typical cases	ESG orientation	Dynamic capabilities implications	Indicative value outcomes
ESG-driven capability building	A1, B2, B3, B4	ESG as strategic lens and innovation driver	Strengthening of sensing, absorptive, adaptive, and reconfiguring capabilities	Sustained or improving long-term firm value
Hybrid ESG (mixed motives)	A2, A3, A6, B6	ESG as both compliance and learning opportunity	Selective capability development, uneven across functions	Moderate, path-dependent value outcomes
Symbolic/compliance ESG	A5, B1, B5	ESG as reporting and legitimacy mechanism	Limited or negative impact on dynamic capabilities, attention diverted to metrics	Short-term valuation gains, long-term stagnation or decline

These patterns illustrate that the same level of externally observed ESG performance can be underpinned by very different capability trajectories, which, in turn, shape long-term value.

The analysis identified three sets of dynamic capabilities that mediate the ESG–long-term value relationship: absorptive, adaptive, and integrative/reconfiguring capabilities.

First, absorptive capabilities mediate the extent to which firms can translate external ESG pressures and knowledge into internal practices that contribute to innovation and risk management. Firms with strong absorptive capabilities maintained dedicated boundary-spanning roles (e.g., ESG officers, regulatory affairs

units) and cross-functional teams that systematically scanned regulatory developments, investor expectations, and technological trends. These firms invested in training and knowledge-sharing platforms that enabled staff in operations, finance, and marketing to understand ESG implications and opportunities. In such cases, ESG performance is associated with the development of new products, services, and operational improvements that support long-term competitiveness.

Second, adaptive capabilities mediate the effectiveness of firms in reconfiguring routines and resource allocations in response to ESG-related experimentation and feedback. Where adaptive capabilities were strong, firms used ESG pilots to test alternative supplier relationships, energy mix strategies, or community engagement models, and then scaled successful approaches. They were also able to adjust quickly when initial ESG initiatives produced unintended consequences or stakeholder resistance, thereby avoiding investments in ineffective practices. In these firms, ESG performance is part of a broader organizational capacity for continuous improvement and strategic flexibility.

Third, integrative or reconfiguring capabilities determine whether ESG initiatives remain peripheral or become embedded in core governance and business models. Firms with strong integrative capabilities link ESG metrics to executive incentives, capital budgeting, risk management frameworks, and board oversight structures. They integrated ESG considerations into mainstream strategic planning and scenario analysis, rather than delegating them to specialized sustainability units. Consequently, ESG performance in these firms is more likely to be accompanied by substantive shifts in resource configurations and value propositions, supporting durable value creation.

Table 3. Mediating role of dynamic capabilities in the ESG–long-term firm value relationship

Case group	ESG performance	Absorptive capability	Adaptive capability	Integrative/reconfiguring capability	Long-term firm value effect
Group 1: Capability-embedded ESG (A1, B2, B3, B4)	Moderate to high	Strong	Strong	Strong	ESG associated with sustained value growth and resilience
Group 2: Partial capability alignment (A2, A3, A6, B6)	Moderate, improving	Moderate	Uneven	Limited	ESG associated with selective value gains and ongoing volatility
Group 3: Capability-decoupled ESG (A5, B1, B5)	High on paper, uneven in practice	Weak	Weak	Weak	ESG associated with short-term value gains followed by stagnation or decline

This pattern supports the proposition that ESG performance alone is insufficient to explain long-term firm value in emerging markets; rather, the configuration of dynamic capabilities mediates the strength and direction of this relationship.

The green paradox in emerging markets

The notion of a green paradox emerged most clearly among Group 3 firms. In these cases, managers reported substantial efforts devoted to ESG disclosure, rating engagement, and external communication. ESG scores and inclusion in sustainability indices attracted positive media coverage and investor interest, leading to short-term increases in market valuation and access to cheaper financing. However, these gains were not matched by corresponding investments in learning, experimentation or internal process change. Over time,

operational problems, regulatory non-compliance incidents, and reputational crises surface, prompting reassessment by investors and stakeholders and resulting in erosion of firm value.

The interviews suggested that the emphasis on symbolic ESG often crowded out deeper capability-building efforts. Resources were allocated to reporting systems and marketing campaigns rather than R&D, human capital development, or supply-chain restructuring. In some cases, sustainability teams operate in isolation from operations, with limited authority to influence strategic decisions. Managers at these firms acknowledged, in hindsight, that "we were chasing the score, not the substance," capturing the essence of the greenwashing paradox.

In contrast, firms in Group 1 experienced ESG as part of a broader strategic renewal process. Their ESG-related disclosures and ratings improved gradually but were grounded in evidence of process changes, innovation, and stakeholder engagement. Investors and analysts perceive these firms as more credible and resilient, particularly during periods of regulatory tightening or market volatility. This contrast underscores that the paradox does not arise from ESG engagement per se, but from ESG practices that undermine or bypass dynamic capability development.

Discussion

The findings contribute to the ESG and strategic management literature in several ways. First, they empirically substantiate the mediating role of dynamic capabilities in the relationship between ESG performance and long-term firm value in emerging markets. While prior quantitative studies have documented the positive average effects of ESG on firm value and proposed mechanisms such as visibility, reputation, and financing cost reduction, they have rarely unpacked the underlying capability-building processes. This study shows that absorptive, adaptive, and integrative capabilities are critical channels through which ESG initiatives translate into an enduring competitive advantage.

Second, this study refines the concept of the green paradox by demonstrating that paradoxical outcomes are deeply rooted in capability-ESG misalignments. In capability-decoupled ESG patterns, firms invest heavily in external signaling and compliance metrics but neglect the internal learning and reconfiguration efforts necessary for sustainability performance. Such configurations may generate short-term valuation premiums but increase long-term vulnerability, as stakeholders eventually detect inconsistencies between rhetoric and practice. Conversely, capability-embedded ESG patterns harness ESG engagement as a driver of dynamic capabilities, thereby turning sustainability pressure into opportunities for strategic renewal (Wilopo et al., 2026).

Third, the findings extend the dynamic capabilities theory in the context of emerging markets. They highlight that ESG capability development is shaped by institutional conditions, including regulatory uncertainty, enforcement gaps, and evolving societal expectations. In these settings, dynamic capabilities must accommodate not only technological and market turbulence but also shifting norms regarding corporate responsibility and stakeholders' rights. Evidence suggests that firms with strong boundary-spanning and stakeholder engagement capacities are better positioned to convert ESG-related institutional changes into competitive advantages.

This study offers several practical insights for managers in emerging markets. First, ESG strategies should be explicitly designed as capability-building programs, rather than isolated compliance projects. This implies the need to dedicate resources to training, cross-functional collaboration, and experimentation to enhance absorptive and adaptive capabilities. It also requires the integration of ESG considerations into core governance mechanisms, including incentive systems, capital allocation processes, and risk management frameworks.

Second, managers should guard against the temptation to prioritize easily measurable ESG indicators or ratings at the expense of the underlying process changes. While external recognition can be valuable, an exclusive focus on scores may encourage superficial initiatives and crowd out investments in innovation, human capital and organizational redesign. Regular internal reviews and stakeholder dialogues can help ensure that ESG activities are substantively aligned with strategic objectives and capability development (Lee et al., 2025).

Third, firms should leverage their position in emerging markets to explore context-specific ESG solutions, rather than merely importing global templates. For example, local community engagement models, labor practices, and governance reforms may offer distinctive opportunities for differentiation and resilience if supported by appropriate dynamic capabilities. Collaboration with local regulators, NGOs, and universities can enrich the knowledge base and support absorptive capacity.

These findings also have implications for policymakers, regulators, and investors. Regulators in emerging markets should recognize that disclosure-based ESG regimes, while necessary, are insufficient to

ensure that ESG performance contributes to long-term value and sustainable development. Complementary instruments, —such as capacity-building programs for firms, guidance on integrating ESG into corporate governance codes, and enforcement actions against greenwashing, —are needed to encourage capability-embedded ESG engagement.

Investors, especially institutional and long-term investor, are encouraged to look beyond ESG scores and standardized ratings to assess firms' dynamic capabilities. This may involve engaging in dialogue with management on how ESG is integrated into strategy and operations, scrutinizing evidence of learning and adaptation, and monitoring the consistency between ESG rhetoric and actual resource allocation. By rewarding firms that demonstrate capability-embedded ESG, investors can help shift incentives away from symbolic compliance towards substantive transformation (Singh, 2026).

While the qualitative design enables deep insights into ESG–capability–value mechanisms, it also imposes limitations. The reliance on a relatively small, purposively selected sample of ESG-active firms means that the prevalence of the identified patterns in the broader population is uncertain. Future research could build on the propositions generated here by designing large-sample, mixed-method studies that combine survey-based measures of dynamic capabilities with ESG and financial data to statistically test mediation effects.

Another avenue for research is to examine the temporal dynamics of capability development in more detail, potentially through longitudinal case studies or panel datasets that track changes in ESG strategies, capabilities and value outcomes over time. Such work could clarify the conditions under which ESG investments initially appear value-destroying but later prove beneficial as capabilities mature or vice versa. Comparative studies across emerging and developed markets would further illuminate how institutional quality and regulatory regimes shape the ESG–capability–value nexus.

CONCLUSION

This study examined the mediating role of dynamic capabilities in the relationship between ESG performance and long-term firm value in emerging markets using a qualitative multiple-case design grounded in interviews and document analysis. The findings demonstrate that ESG performance alone does not guarantee enduring value; rather, the development of absorptive, adaptive, and integrative capabilities determines whether ESG engagement serves as a catalyst for strategic renewal or degenerates into a form of symbolic compliance that undermines long-term competitiveness. This study introduces the notion of a green paradox in emerging markets, whereby capability-decoupled ESG practices yield short-term valuation gains but erode dynamic capabilities and future value. By highlighting the importance of capability-embedded ESG strategies, this study contributes to the ESG and dynamic capabilities literature and offers actionable insights for managers, policymakers, and investors seeking to harness ESG for sustainable value creation in emerging-market contexts.

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