ABSTRACT

The growing integration of sustainability considerations in investment decision-making has encouraged the development of asset pricing models that incorporate non-financial risk factors. In emerging markets such as Indonesia, the relevance of Environmental, Social, and Governance (ESG) factors remains important to examine because investor attention to sustainability has increased, while empirical evidence on ESG as an additional risk factor is still limited. This study examines the role of Environmental, Social, and Governance (ESG) scores in enhancing the explanatory power of the Fama–French Three-Factor Model for portfolio excess returns on the Indonesia Stock Exchange during 2021–2024. Using Bloomberg Terminal data and purposive sampling, a total of 139 listed companies were selected. The analysis was conducted using time-series regression with Newey-West standard errors, Adjusted R-Square, AIC, and BIC. The findings indicate that SMB and HML significantly affect portfolio excess returns, while the market risk premium and ESG factor do not show significant individual effects. Nevertheless, the inclusion of ESG improves the model's explanatory power, as reflected by the increase in the average Adjusted R-Square from 24.01% to 29.36%. However, the ESG-adjusted model generates higher AIC and BIC values, indicating lower model efficiency. These results suggest that ESG provides additional explanatory information but has not yet become an efficient standalone risk factor in the Indonesian capital market.

Keywords: Fama–French Three-Factor Model; ESG; Asset Pricing; Portfolio Excess Return; Indonesia Stock Exchange; SMB; HML.