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The Influence of Environmental, Social and Governance Performance on Financial Performance with Company Type ad Moderator

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Abstract: This study aims to determine the influence of Environmental, Social, and Givernance Performance on Financial Performance. This research method used is a quantitative method. The data used in this study is secondary data in the form the websited (www.idx.co.id) and Refinitiv Eikon. The population in this study are companies listed on the Indonesia Stock Exchange (IDX) for the period 2014 - 2023. The sample was selected from the purposive sampling method and obtained a sample of 35 companies from several predetermined criteria. The analysis technique used in this research is panel regression analysis with the help of Eviews version 12. The results of the analysis show that Environmental Performance has no significant positive effect on Financial Performance. Social Performance has a positive and significant effect on Financial Performance. Governance performance has a negative and significant effect on financial performance. Environmental Performance has no significant effect on Financial Performance moderated by Company Type. This research can contribute to add literature related to additional considerations such as Environmental Performance, Social Performance, Governance Performance and Financial Performance for investors in evaluating the company's potential.

Keyword: ESG Performance, Financial Performance, Company's Type

INTRODUCTION

Financial performance is an analysis that carried out to know the extent to which a company has carried out its functions using the rules of financial implementation properly and correctly (Hutabarat and Puspitasari, 2020). The better the financial performance of a company, the greater the company's chances of achieving financial goals, increasing value for shareholders, and being able to predict future financial performance (Malau, 2019). However, today companies do not only focus on financial aspects, but there is an increased interest in companies to engage in business management or sustainable development where companies strategize operations to be responsible for creating a long-term positive impact on society and the environment (ESG) (Lee and Isa, 2022). Corporate sustainability can balance the economic, social, and environmental needs of the future and present. Although spending resources on ESG activities might seem to be an additional cost that could detract from short-term profit maximization, it can be crucial investment in the company's long-term sustainability and financial success. The environmental elements focus on how a company address its impact on the natural world and its commitment to sustainability. The social factors are concerned with how companies manage relationships with their employee, customer, suppliers, and the broader society. And the governance elements are about how a company is directed and controlled, ensuring that decisions made by the board and management align with the interest of stakeholders.

The application of ESG can minimize the level of environmental damage and social inequality which is currently a serious problem (Sugianingrat *et al.*, 2023), which actually occurs due to the development and growth of companies in each country. Their goals in obtaining profits can make them do various ways to achieve their goals, one of which is by using social resources and society uncontrollably so it can disrupt the environment and ultimately disrupt human life, especially the community around the company operates. Whereas when they are able to apply ESG correctly and appropriately, it will be able to increase the value of the company and improve the company's reputation in the long run, so that it will attract investors to invest, which has an impact on the long-term survival of the company (Sarnisa et., 2022). Indonesia is recognized for having a better economy, outperforming many other countries, as noted by Hartono (2022) based on (Pangastuti, 2022). This aligns with a report by CNBC in September 2022, which highlighted that the year had been one of the most prosperous for Indonesia's economy.

According to Refinitiv data, by the second week of September, 660 out of 813 companies listed on the stock exchange had reported their financial performance. The aggregate results revealed a significant surge in total profits, which increased by 72%, rising from IDR 189.36 trillion to IDR 325.96 trillion.

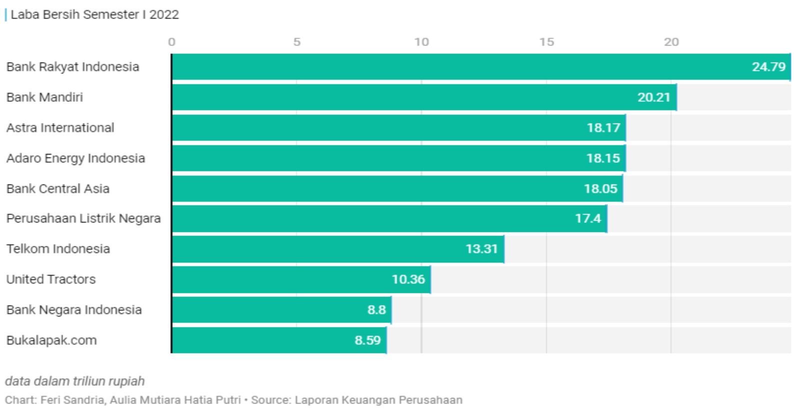

Figure 1. ESG Starlist Company

According to IDX data, four company on the ESG Star List have the highest profits in Indonesia, and 7 of 8 ESG Star List company are the 100 largest companies in Indonesia. This data highlights that companies practicing ESG (Environmental, Social, and Governance) principles have seen significant improvements in their performance. It demonstrates that an increasing number of companies are focusing on non-financial aspects to create value and foster sustainable development. And IDX data reveal from 800 listed companies, only 124 have ESG scores, indicating that the adoption of ESG practices remains relatively low among companies. However, as highlighted earlier, the implementation of ESG practice can enhance a company's performance and value. Therefore, the Indonesia Stock Exchange (IDX) continues to encourage the integration of environmental, social, and governance (ESG) aspects by businesses in Indonesia to support sustainable performance in the capital market. Market participants are urged to prepare for the implementation of ESG initiatives, which will help foster sustainable finance in Indonesia's capital market. This will allow the Indonesian capital market to advance and make a greater contribution to the country's economy. However, many companies unable to realize the potential of these ESG practices. Some of the latest issues related to ESG practices are the Jiwasraya Insurance problem that failed to maintain trust in customers by failing to pay for claims due to JS Saving customers, PT Asabri committed fraud, PT GNI have a labor issue, Garuda Indonesia experienced financial problems, and PT Kimu Sukses Abadi (KSA) in West Cikarang experienced environmental pollution issues. Although the instability of ESG implementation and the associated challenges can make it seem like a burden to companies, the benefits of adopting ESG practices are becoming increasingly evident. With the right strategies, businesses can turn ESG implementation into an opportunity for growth, enhanced reputation, and improved stakeholder trust. By embracing ESG not as a compliance requirement but as a core aspect of their business strategy, companies can build long-term value while contributing positively to society and the environment.

According to Chouaibi and Chouaibi, 2021) show that a higher commitment to greater ESG practices appears to impact firm performance. Companies that engage in these practices are shown to be more likely to ensure a sustainable competitive advantage. Resuearch conducted by Lee and Isa (2022) and Suretno et al. (2021) ESG can enhance financial performance. According to Han et al. (2016) Indeed, the relationship between ESG and financial performance has been widely studied across different sectors. According to Tandelilin and Usman (2022) shown CSR has a negative relationship with bank performance, whether measured by accounting performance or market performance. This align with Husada and Handayani (2021), Dragomir et al. (2022), and (Putra, 2021) shown that in financial sector companies, environmental performance has no influence on financial performance. This happens for the reason that investors in the financial sector have not considered environmental practices and disclosures as one of the factors that determine investment in a company.

From the explanation above, we know that the effect of ESG on financial performance shows inconsistent results, especially in environmental performance aspect. This indicates that there are other factors that influence ESG performance on the company's financial performance. One of the factor is type of company. According to Omar and Zallom (2016) and Bayoud et al. (2012) company's type have a significant effect to financial performance.

METHOD

This research is conducted to test the hypothesis. The hypothesis test is aimed at explaining the nature of certain relationship. The dependent variable is this study is Financial Performance, while the independent varibales are Environmental Performance, Social Performance, and Governance Performance. Additionally, this study uses control variables, namely Firm Size, Age, and Leverage. Lastly this study also use moderation variable which is Companies Type. This research employs panel data regression analysis and will be processed using Eviews 12.

The study also uses secondary data. The secondary data for this research is sourced from the annual financial reports of companies listed on the Indonesia Stock Exchange (IDX) from 2014-2023, as well as ESG score data from the Thomson Routers Eikon Database. The population of this study consist of all companies listed on the IDX during 2014 – 2023 period. The sampel is obtained using purposive sampling techniques based on several predetermined criteria. The sampel in this study include 35 companies over the 2014 – 2023 period, resulting in a total of 227 observations. The operastional definitions and research variabels are as follows:

Table 1. Operational Definition and Reasearch Variables

Variable	Definition	Measurement	Resources
Financial Performance (ROA)	A ratio that measures how efficiently a company generates profits from its owned assets	Net profit (loss) pf the current year / total assets	(Ross *et al.*, 2006)
Environmental Performance	A criterion that discusses investor considerations of company performance in an environementally friendly way	Environmental Score Pillar	Refinitiv Eikon
Social Performance	Social aspects in ESG are criteria that discuss a company's relationship with external parties, which includes communities, society, suppliers, buyers, media, and other entities that have direct or indirect relationships.	Social Score Pillar	Refinitiv Eikon
Govermance Performance	Governance in ESG focuses on how a company has a good and sustainable management process internally	Governance Score Pillar	Refinitiv Eikon
Company size	Indicates the size of the company, measured by using the natural logarithm of total asset	Natural Logarithim of total assets	(Sugiarto, 2011)
Age	The age of a company shows how long the company has been established and running its business.	Ln (Year of Observation - year of establishment)	(Pradana and Suzan, 2016)
Leverage	The ratio that measures how much a company uses debt compared to its assets	Total liabilities / total assets	(Wardani & Hamdan, 2020)
Company's Type	grouping of companies based on their type	Financing Company = 0, Non-Financing Company = 1	(Bayoud, Kavanagh and Slaughter, 2012)

Source: Previous Research

The Model used in this research is a panel regression model. The moder is as follows:
ROA = a + b1Env + b2Soc + b3Gov + b4Size + b5Age + b6Lev + b7Env*Type

Explanation:

ROA	: Financial Performance
a	: Constant
b1, b2, b3	: Regression coefficients
Env	: Environemntal Performance
Soc	: Social Performance
Gov	: Governance Performance
Size	: Company Size
Age	: Age
Lev	: Leverage
e	: Error standars

Conceptual Framework

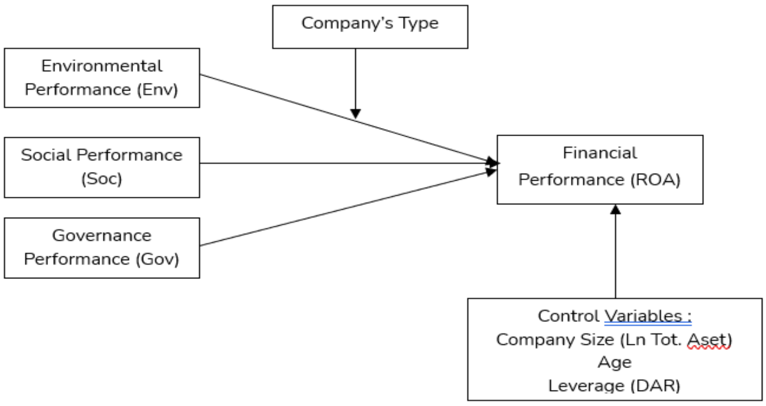

Figure 2. Conceptual Framework

RESULTS AND DISCUSSION

Descriptive Statistical Analysis

Table 2. Descriptive Statistical Analysis

	ROA	ENV	SOC	GOV	SIZE	AGE	LEVERAGE	TYPE
Mean	0.107	53.159	66.542	61.564	18.360	3.861	0.508	0.793
Median	0.061	53.119	69.318	62.191	18.196	3.891	0.453	1
Maximum	1.136	89.166	93.897	94.013	21.499	4.852	1.899	1
Minimum	0.644	26.098	25.117	25.106	15.564	2.397	0.005	0
Std. Dev.	0.156	17.665	16.838	17.742	1.385	0.461	0.298	0.406
Observations	227	227	227	227	227	227	227	227

Source: Processed Data from Eviews 12

Selection of Panel Data regression Model

Chow Test

From the results of the model analysis using the Chow Test, the following results were obtained:

Table 3. Chow Test Results

Effects Test	Statistic	Df	Prob
Cross-Section F	3.470794	(34.186)	0.0000
Cross-section Chi-Square	111.526015	34	0.0000

Source: Processed Data from Eviews 12

The result of the Chow test in the table above show that the probability value of cross-section chi-square is <0.05, namely 0.0000, which means that H0 is rejected and Ha is accepted. This indicates that the regression model chosen will be the fixed effect model (FEM). The analysis is then that continued with the Hausman test.

Hausman Test

The result of the Hausman test are as follows:

Table 4. Hausman Test Results

Test Summary	Chi-Sq.Statistic	Chi-Sq df	Prob.
Cross-section random	3.3761	6	0.7604

The result of the Hausman test in the table above, the probability value obtained is 0.7604, showing that the probability value is >0.05, so it can be concluded that the correct mode to choose is the Random Effect Model (REM). Since there is a difference in the model used from the result of the Chow and Hausman Test, So the analysis is continued with Lagrange Model test.

Lagrange Model Test

Table 5. Lagrange Model

	Cross-section	Test hypothesis time	Both
Breusch-Pagan	43.4644	0.021959	43.4864
	0.0000	0.8822	0.0000

The result of of the Lagrange Model test in the table above, the probability value obtained is 0.0000, showing the probability value is <0.05, which means H0 is accepted and Ha is rejected. This indicates that the regression model chosen will be the Random Effect Model (REM). According to (Gujarati, 2003), the equation that meet the classical assumption is only the equation that uses the Generalized Least Square (GLS) method. In Eviews, the estimation model that uses the GLS method is only Random Effect Model. Based on the selections of the estimation method in table above show that Random Effect Model (REM) is suitable for the regression equation, so it is not necessary to do the classical assumption test.

Panel Data Regression Model

The selected panel data regression model is the Random Effect Model. As determined by The Chow, Hausman, and the Lagrange Test. The results of the panel data regression analysis are as follows:

Table 6. Regression Result with the Random Effect Model (REM)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.954267	0.307429	3.104026	0.002200
ENV	0.001351	0.000988	1.367653	0.172800
SOC	0.001598	0.000770	2.075065	0.039100
GOV	-0.002384	0.000631	-3.779058	0.000200
SIZE	-0.055417	0.015195	-3.646969	0.000300
AGE	0.065574	0.032674	2.006902	0.046000
LEVERAGE	-0.118122	0.043681	-2.704179	0.007400
ENV_TYPE	-0.001268	0.000946	-1.340815	0.181400

Source: Processed Data from Eviews 12

Based on the table above, the regression equation is as follows:

$$Roa = 0{,}954267 + 0{,}001351 Env + 0{,}001598 Soc - 0{,}002384 Gov - 0{,}055417 Size + 0{,}065574 Age - 0{,}118122 Lev - 0{,}001268 Env * Type$$

Hypothesis Testing

Coefficient of Determination (R^2)

The following are the results of the coefficient of determination (R^2) test:

Table 7. Coefficient of Determination (R^2) Test

Weighte Statistic

Adjusted R-squared	0.150867

Source: Processed Data from Eviews 12

Based on the result of the Random Effect Model test, the obtained R-Squared value is 0.150867. This indicated that the independent variables, which includes consisting of Environmental performance, social performance, and governance performance, along with the control variables consisting of firm size, age, and leverage, can explain the dependent variable of Financial Performance by 15.08%, while the remaining 84,92% is determined by others factor outside the model that are not detected in this study.

F-Test Results

The F-Test resulrs obtained are follows:

Table 8. F-Test Results

Weighted Statistic F-statistic	6.736259
Prob(F-statistic)	0.000000

Source: Processed Data from Eviews 12

Based on the Random Effect Model test, the analysis shows a significant value of 0.0000 < 0.05. Therefore it can be concluded that the independent variables collectively influence the dependent variabel (Y), making the model considered valid.

T-Test Results

The T-Test results obtained are as follows:

Table 9. T-Test Results

Variable	Coefficient	Prob.	Informantion
C	0.954267	0.002200	
ENV	0.001351	0.172800	Does not Significantly influence
SOC	0.001598	0.039100	Positively and Significantly Influence
GOV	-0.002384	0.000200	Negatively and Significantly Influence
SIZE	-0.055417	0.000300	Negatively and Significantly Influence
AGE	0.065574	0.046000	Positively and Significantly Influence
LEVERAGE	-0.118122	0.007400	Negatively and Significantly Influence
ENV_TYPE	-0.001268	0.181400	Does not Significantly Influence

Source: Processed Data from Eviews 12

The Influence of Environmental Performance on Financial Performance

The result show that Environmental Performance does not significantly influence on Financial Performance. This align with Agency Theory, which state that agents and stakeholder have different goals, agents act for personal benefits in the form of reputation while the stakeholder goal is profit. So that companies try to minimize expenses related to environmental practices, and diverted to maximize profits for stakeholder (Husada and Handayani, 2021). These result are consistent with studies by (Ruan and Liu, 2021), (Shakil *et al.*, 2019), and (Delmas and Angeles, 2016) find no relationship between environmental performance and financial performance. The evidence suggest that company perceive environmental initiative as potential cost. Conversely, the studies by (Inawati and Rahmawati, 2023) found that environmental performance have a significant affect on financial performance.

The Influence of Social Performance on Financial Performance

The result show that Social Performance has a positive and significant influence on financial performance. This aligh with the stakeholder theory, which explain that social performance can improve company performance by influencing the desire of all stakeholders to contribute their resources and efforts. This is done by managing competing interests among stakeholders, In legitimacy theory also says that companies do various ways by starting and changing their operational activities that are in accordance with public perceptions so that they can influence public perceptions and assessments of the company. This study align with the finding of (Aboud and Diab, 2018), and (Ghardallou and Alessa, 2022) that find social performance can contribute to the level of investor trust and corporate reputation, which can be a potential in improving the company's performance and build sustainable relationship with stakeholders, but contradict study by Christy and Sofie, (2023) and Firmansyah et al. (2021) that show social performance cannot explain the financial performance. Even though companies improve social performance, it does not guarantee that it can improve the company's financial performance or attract investor interest. Most investors assume that the social activities carried out by the company can actually increase the cost burden that can reduce company profits.

The Influence of Governance Performance on Financial Performance

The result show that Governance Performance has a negative and significant influence on financial performance. This align with Arofah and Khomsiyah (2023), Suretno et al. (2021), Firmansyah et al. (2021) shown governance performance governance performance can reduce financial performance, While strong corporate governance is essential for long-term sustainability and reputation, the challenges of implementing governance reforms in the face of regulatory gaps**,** weak supervision**,** cultural barriers, and financial pressures can lead to short-term financial performance declines. These challenges can result in higher compliance costs**,** operational disruptions, and misalignment with market expectations, which may temporarily harm profitability. Ruan and Liu, (2021) show institutional systems and protection for investors in developing countries are generally relatively low so to build a good level of trust with investors companies need to invest more in corporate governance mechanisms, because basically the adoption of the use and implementation of good governance in Indonesia as a whole is still new which needs to be improved and increased. Conversely, the study by Han et al. (2016), Alareeni and Hamdan, (2020) shown governance performance have a positive significant effect on financial performance.

The Influence of Environmental Performance on Financial Performance with company's type as moderating

The result show that environmental performance has no effect on financial performance with company's type as moderating, it shown Company's type does not help strengthen or weaken the influence of environmental performance on financial performance. This align with Astuti (2018) shown that company's type does not strengthen the effect of financial performance on firm value. The results obtained show that industry type is not able to explain the effect of ESG on financial performance. According to Naeem et al. (2022) in developing countries environmentally sensitive companies (non-financial companies) remain insignificant and convincing, which indicates that more emphasis is needed on ESG strategies and initiatives in the country.Conversely, the study by Bayoud et al. (2012) showm company's type can strengthen the influence between CSR and financial performance. Studies show that activities and their disclosures are systematically determined by firm characteristics that affect financial performance levels. In addition, the performance of companies in industries that are more sensitive to the environment shows better results.

CONCLUSION

The findings indicate that Environmental Performance does not have a significant positive effect on financial performance. Corporate engagement in environmental practices is viewed as an increase in costs and a waste of resources, which can negatively affect profits. Moreover, investors tend to focus more on financial factors and are hesitant to invest in companies with a strong environmental responsibility record. On the other hand, Social Performance has a positive and significant impact on financial performance. Company involvement in social activities enhances investor trust and the company's reputation, which can contribute to improved financial outcomes. Governance Performance has a negative and significant effect on financial performance due to the suboptimal implementation of corporate governance practices in Indonesia, which are not fully aligned with governance principles and still have weaknesses in the guidelines. Environmental Performance, when moderated by Company Type, does not significantly influence (either weaken or strengthen) financial performance. The implementation of environmental practices in both company types is not yet optimal, indicating the need for greater emphasis on strategic initiatives. Furthermore, Company Size negatively and significantly impacts financial performance. Larger companies do not necessarily perform better financially, as the costs associated with maintaining large assets can outweigh the benefits. Company Age, however, has a positive and significant effect on financial performance, as companies with longer operational histories demonstrate stability and the ability to sustain profit growth. Finally, Leverage shows a negative and significant effect on financial performance.

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