JURNAL ILMIAH
Bisnis dan Ekonomi Asia
Terakreditasi Sinta 3 SK No: 105/E/KPT/2022
htttps://jurnal.stie.asia.ac.id/index.php/jibeka

THE EFFECTS OF ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG) ON CORPORATE PERFORMANCE

Henri Martha[1*], Khomsiyah[2]
[1,2]Universitas Trisakti Jakarta, Indonesia

Article's Information

DOI:
10.32812/jibeka.v17i1.1380

ISSN:
0126-1258

ISSN-E:
2620-875X

CORRESPONDENCE*:
zainuri.feb@unej.ac.id

ABSTRACT

This study aims to analyze the impact of economic growth, trade openness and political stability on the development of the stock market in ASEAN-5 including the Philippines, Indonesia, Malaysia, Thailand and Vietnam. in the period 2008-2020. The sampling method uses the purposeful sampling method that uses the control panel Vector True Error Model (PVECM) analysis method. Research results show that economic growth has no impact on stock market development. This study also finds evidence that there is a causal relationship between economic growth and stock market development. The opening of trading has a significant negative influence on the stock market's movements in the short and long term. Political stability has a significant positive impact on stock market movements in the short and long term.

Keywords: *ESG score*, *Tobin'S Q*, ROA, ROE

ABSTRAK

Penelitian ini bertujuan untuk membahas dampak environmental, social, governance (ESG) terhadap kinerja pasar. Metode penelitian menggunakan penelitian kuantitatif deskriptif. Populasi penelitian ini adalah perusahaan yang telah terdaftar di Bursa Efek Indonesia (BEI) dari tahun 2016 hingga 2020. Metode penelitian dalam pengambilan sampel menggunakan metode *purposive sampling* dengan sampel sebesar 67 perusahaan dari total 82 jumlah responden yang menjadi populasi.. Metode analisis yang dilakukan dalam penelitian ini adalah metode regresi. Hasil penelitian menunjukan bahwa Tobin's berpengaruh negatif dan bersignifikan terhadap skor ESG melalui ROA dan ROE.

Kata Kunci: ESG Score, Tobin's Q, ROA, ROE

Introduction

Nowadays, the global challenges of climate change and pandemic are still happening in various countries, including Indonesia (Irawati 2020). Global public awareness is getting increase on the interconnectedness of these two things. Thus, a step together is needed to deal with the negative impacts caused in various aspects (Charity 2017). This global challenge has encouraged various parties, especially global and domestic investors, to realize the importance of implementing *Environmental, Social,* and *Governance* (ESG) in all business and development activities. It is expected that the recovery of post-pandemic economics can take place in a sustainable manner (Nizam et al. 2019). The sustainability report presents non-financial information of the company, explains the economic, environmental, and social aspects of the company. Then, the three components of the sustainability report include environmental, social, and governance or ESG (Tarmuji, Maelah, and Tarmuji 2016). ESG disclosure can provide benefits for companies and stakeholders. Sustainability reports will lead to good decision making, transparency, and sustainable financial stability (Mohammad and Wasiuzzaman 2021).

Stakeholder theory is one of the strategic issues related to how companies manage relationships with stakeholders where companies are required to pay attention and provide benefits to stakeholders because their existence is able to influence or be influenced by the policies taken by the company in its business activities (Freeman, Phillips, and Sisodia 2020). In this condition, stakeholders are not only focused on shareholders. Stakeholder theory provide extends to all stakeholders rather than just to the owners or investors of the organisation's responsibilities. Companies should find support from every stakeholder company for business activities carried out. Its support is very meaningful for the survival of the company (Freeman, Dmytriyev, and Phillips 2021).

In business activities undertaken, the company is expected to be able to meet the expectations and demands of their stakeholders (Barney and Harrison 2020). Its support can be obtained by the company through the practice of disclosure of both financial and non-financial information where the stakeholders expect management to report on all business activities undertaken. Disclosure of company information is important to maintain relationships and improve the company's reputation with the stakeholders (Kujala, A. M. Lämsä, and Riivari 2017). Support and attention given by the stakeholders is expected to be able to have a positive effect on the performance of the company through the investment support or equity participation. These can improve the company's operations as well as through the support of the use of the company's products by the other stakeholders . Thus, the company will be able to achieve profit targets. High level profit achievement will certainly have an impact on the profitability ratio (Kujala, A.-M. Lämsä, and Riivari 2017).

Theory of signalling states that in a transaction the parties involved have different levels of information from each other where the information has a value. Signal by the company is considered an important thing that has an influence on the assessment of investment decisions from the parties outside the company (Karen and Susanti 2019). Signals can be interpreted as a signal given to outside parties (investors) where the signal has been prepared by the company (manager) itself. All forms of signals issued by the company are intended to imply something, So, that changes in the valuation of the company are expected by the market or external parties. Therefore, the signal to be announced by the company must have the information power that can change the views of external parties related to the assessment of the company (Novia 2018).

A form of non-financial information disclosure, such as ESG disclosure can also be assumed as a good signal. It is expected to be able received by other parties that can influence decision making (Mohammad and Wasiuzzaman 2021). A positive signal for investors appeared in the disclosure of the company's non-financial information about the environment, social, and corporate governance (Setyahuni and Handayani 2020). Positive signals by investors will cause the company to obtain a good valuation of investors assumption through increased stock demand transactions resulting in an increase of stock prices that have a positive impact on the company value (Plastun et al. 2019).

The company must concern to all its activities to be in accordance to the values and social norms that apply in the community of the company's location with the aim that the company gains legitimacy from the community (Abarca 2021; Noorkusuma 2017). The companies need to ensure that its activities are accepted by outside parties as recognized. However, the differences in the values held by the company with the values believed by the community are found in this study. These differences, between the values of the company and the social values of the community, can affect the company's ability to continue its business activities. For this reason, companies need to evaluate social values and make adjustments to social values in society or perceptions of the company as a legitimacy tactic (Permatasari, Luh, and Setyastrini 2019).

One way to reduce this legitimacy gap is by disclosing accountability for environmental, social, and corporate governance practices (Alexander, Doorn, and Priest 2018). The organisation in a company is the social system part of society which tries to create harmony between social values and norms in social life in society (König and Wenzelburger 2021). Therefore, the company will gain recognition from the community for the creation of harmony in values and norms owned by the company with those owned by the community. It will provide an impact on the sustainability of the company so that superior performance is obtained (Lelkes 2016).

Based on previous research of the ESG disclosure in the financial statements of the company's performance, which examines the effect of ESG practices on economic performance. A positive result was shown between ESG practices and economic performance. Companies that have consistent performance showed better ESG practices and economic performance than other companies (Duarte, Costa e Silva, and Ferreira 2018). This positive result is also found in the results of the study which stated a positive effect of ESG on financial performance. Previous research was also conducted by (Climent), which examined the effect of ESG on financial performance of Return on Assets and Return on Equity, which indicates a negative result (Miralles-Quirós, Miralles-Quirós, and Hernández 2019).

Negative results obtained because the company which implements the ethical practice has a greater cost to finance social projects, thus compromising the company's return. The results of ESG studies are not significant and or negative, on *Return on Assets, Return on Equity,* and *Tobin's Q* (Miralles-Quirós et al. 2019). This article explained about the effect of Environmental, Social, and Governance (ESG) on the companies' performance listed on the Indonesia Stock Exchange in 2016-2020.

Method

Research methods used descriptive quantitative research (Sugiyono 2019). The population that became the object of this study were companies that have been listed on the Indonesia Stock Exchange (IDX) from 2016 to 2020. Research sampling methods employed the purposive sampling method. Based on the results of sampling , the sample object of 67 companies became a research sample of a total of 82 existing populations. There are three variables, namely independent variables, dependent variables, and moderation variables. Independent variable in this study is ESG disclosure in which the form of measurement is in the form of a score. ESG disclosure has several designations, such as ESG reporting, sustainability reporting, or CSR reporting. This term refers to the data disclosure related to environmental performance (environmental), social (social), and governance (governance) of a company or organisation. Its disclosure enables the investors to make decisions based on information identifying companies that may be at risk or underperform due to problems in ESG. The method of analysis conducted is the regression method.

Result and Discussion

Descriptive statistical analysis is a data description of the minimum value, maximum value, average value (mean), and standard deviation. These can be seen in Table 1 below.

Table 1. Result of Descriptive Analysis

Parameter	ESG	Tobin's Q	ROA	ROE
Minimum	1773.00	55.00	-449.00	-1104.00
Maximum	6704.00	160.00	1008.00	2539.00
Mean	3719.57	103.17	275.99	772.93
Std. Dev.	1115.71	22.31	296.28	700.24

Source: Data Processing Result through SPSS 26

Results of Descriptive Statistical Analysis related to *ESG disclosure* found the minimum value of 1773.00, the maximum value of 6704.00, and the average value (mean) 3719.57 with a standard deviation of 1115.71. Minimum value of *Tobin' S Q* showed 55.00 and the maximum value showed 160.00, while the average value (mean)103.17 with a standard deviation of 22.31. Then, it was found that ROA minimum value of -449.00, the maximum value of 1008.00 and the average value (mean) of 275.99 with a standard deviation of 296.28. Meanwhile, related to ROE, there is a minimum value of -1104.00, a maximum value of 2539.00 and an average value (mean) of 772.93 with a standard deviation of 700.24.

Linear regression is used to test the extent to which the causal relationship between the independent variables of *ESG disclosure* and the dependent variable of *Tobin ' S Q* with control variables are ROA and ROE. The data are presented in table 2.

Table 2. Results of Hypothesis Test

Variable	Stand Beta	t	Sig.
Constant		17.395	0.000
ESG	0.178	2.994	0.003
ROA	0.157	1.573	0.117
ROE	0.157	1.568	0.118
Adjusted R Square			0.115
F Test			11.926
Sig.			0.000

Source: Data Processing Result through SPSS 26

In this study, regression analysis resulted in a significance value of 0.000. This significance value is smaller than the significance level of 0.05. It reveals that *ESG disclosure* has a significant effect on the market performance (*Tobin' S Q*). Therefore, the hypothesis in this study is accepted. These results are also in line with signalling theory, which emphasises that *ESG disclosure* is assumed as a good signal that will obtain a positive response from investors regarding the company value. These results are in accordance with the stakeholders theory which stated that the existence of these stakeholders showed a significant effect on the sustainability of the company's operations through the support and trust that has been given. In addition, it can improve the company's reputation so that superior performance is obtained (Barney and Harrison 2020). This is in accordance with the statement that stakeholders are a group that significantly affects the success or failure of an organisation. The success of products and services is ultimately determined by the interests of coalition partners, which are different from the interests of other stakeholders. In addition, the results of this study are in accordance with the legitimacy theory, which states that the provision of non-financial information is one approach to gain public credibility (Permatasari et al. 2019). It is expected that the rate of return on the company's assets used to generate corporate profits will increase the company's information disclosure which encourages the support and trust of the public and stakeholders. It is also supported through the use of the company's products or the incorporation of working capital in the form of assets that will improve the company's operations. It is very important for an organisation to meet the expectations of its stakeholders in order to get their support in producing good performance. Since the stakeholders are interested in a company's sustainability strategy, better ESG reporting will result in better CSR performance indicators, such as CSR ratings or reputation factors (Tamimi & Sebastianelli, 2017).

The results of this test confirm the findings of previous studies conducted which stated that ESG disclosure provides a beneficial effect on ROA. It indicates that the rate of return on company assets will increase proportionally to the ESG disclosure company. It is based on the assumption that stakeholders are interested in the company's sustainable strategy. The improved ESG reporting will lead to improved company performance as a result of increased stakeholder confidence, which will finally lead to improved non-financial conditions (Duque-Grisales and Aguilera-Caracuel 2021; Nizam et al. 2019).

The findings of this study are in line with the findings of (Alareeni & Hamdan, 2020), which found a significant positive relationship between ESG and Tobin's Q, where *ESG disclosure* effect on increasing business value. In addition, (Nirino et al, 2021) found that *ESG disclosure* has significant effect on company performance evaluated by market performance (Tobin's Q). The results also show that *ESG disclosure* become a factor considered by stakeholders, especially investors, in making investment decisions (Feng and Wu 2021).

The findings of this study contradict the findings by (Alareeni & Hamdan, 2020), which found a significant positive association between ESG and Tobin's Q, where ESG disclosure affects increasing business value. In addition, Nirino et al. (2021) found that ESG disclosure gives no significant effect on the company performance evaluated by market performance (Tobin's Q). The results also show that ESG disclosure has not been a factor considered by stakeholders, especially investors, in making investment decisions. However, previous studies revealed that the improvement in ESG performance is not reflected in the stock price, which reflects the company value la Torre et al. (2020). These findings are also consistent with previous research conducted which argued that ESG has no ability to increase company value. This is based on the argument that, in order to maintain the company's activities that are not in line with the company's objectives, it is necessary to focus on the allocation of CSR funds, which can lead the increase expenses that can negatively affect the financial condition of the company (Duque-Grisales and Aguilera-Caracuel 2021).

This can be explained by the idea that the non-financial information disclosure has a detrimental effect on the production of the company's value. This is the result of the company to meet the needs of its stakeholders, thus causing further agency conflicts (Abdullah et al., 2015). Thus, the results of the study related to the ESG disclosure has decreased the company value due to the relatively low level of investor confidence in the given signals. Investors usually do not respond positively to these signals. Investors assume that the activities stated in the ESG report are too expensive/costly and detrimental to their interests. So, they are not interested in investing (Dahiya & Singh, 2021). This resulted in a decrease in market demand which led to a decrease in the company value, which is reflected in a decrease of stock prices (Rizqi et al. 2021).

Non-financial information disclosure, such as ESG which provides information related to environmental, social, and corporate governance can be seen as part of the company's efforts to be able to meet the demands of stakeholders and achieve harmony of values and norms in society. So, these stakeholders can provide support and trust for all business activities of the company, which will increase the company's sales or services (Albitar et al., 2020; Giannarakis, 2014). Thus, an increase in the company's income will be accompanied by an increase in the value of the return on capital used by the company to carry out commercial activities.

The findings is in line with research from Buallay (2019) which shows that ESG disclosure has positive impact on the rate of capital return, where ESG disclosure is able to reduce the level of business risk that may occur due to practices related to the corporate social environment carried out by stakeholders who consider that the companies have a high level of sustainability. This will eventually enable them to gain the support of the company's stakeholders through stock participation and the use of the company's products and services.

This can be explained through the idea that non-financial information disclosure has a beneficial impact on the production of corporate value, which is the result of the company fulfilling the needs of its stakeholders. Therefore, the results *ESG disclosure* study increase the company value due to the level of investor confidence in the signals provided. Investors usually respond positively to these signals. Investors assume that the disclosed activities in the ESG report gives benefit to their interests, so they are interested in investing (Dahiya &

Singh, 2021). This causes an increasing market demand which ultimately leads to an increase in the company value as reflected by the increase in the stock price (Rizqi, Yudiana, and Damayanti 2021).

Conclusion

Variable testing of *ESG disclosure* has a positive effect on the company's market performance. Therefore, the hypothesis is accepted. The contribution of this study states that with the *ESG disclosure* signal, it can predict the company's market performance. Limitations in this study are the samples used which are only companies listed on the Indonesia Stock Exchange. So, it is necessary to conduct further research with companies listed on other Southeast Asian stock exchanges with different objects and more samples.

Reference

Abarca, Roberto Maldonado. 2021. "Teori Legitimasi." *Nuevos Sistemas de Comunicación e Información*.

Alexander, Meghan, Neelke Doorn, and Sally Priest. 2018. "Bridging the Legitimacy Gap—Translating Theory into Practical Signposts for Legitimate Flood Risk Governance." *Regional Environmental Change* 18(2). doi: 10.1007/s10113-017-1195-4.

Barney, Jay B., and Jeffrey S. Harrison. 2020. "Stakeholder Theory at the Crossroads." *Business and Society* 59(2).

Charity, May Lim. 2017. "JAMINAN PRODUK HALAL DI INDONESIA (HALAL PRODUCTS GUARANTEE IN INDONESIA)." *Legislasi Indonesia* 14(1).

Duarte, Paulo, Susana Costa e Silva, and Margarida Bernardo Ferreira. 2018. "How Convenient Is It? Delivering Online Shopping Convenience to Enhance Customer Satisfaction and Encourage e-WOM." *Journal of Retailing and Consumer Services* 44:161–69. doi: 10.1016/j.jretconser.2018.06.007.

Duque-Grisales, Eduardo, and Javier Aguilera-Caracuel. 2021. "Environmental, Social and Governance (ESG) Scores and Financial Performance of Multilatinas: Moderating Effects of Geographic International Diversification and Financial Slack." *Journal of Business Ethics* 168(2). doi: 10.1007/s10551-019-04177-w.

Feng, Zifeng, and Zhonghua Wu. 2021. "ESG Disclosure, REIT Debt Financing and Firm Value." *Journal of Real Estate Finance and Economics*. doi: 10.1007/s11146-021-09857-x.

Freeman, R. Edward, Sergiy D. Dmytriyev, and Robert A. Phillips. 2021. "Stakeholder Theory and the Resource-Based View of the Firm." *Journal of Management* 47(7). doi: 10.1177/0149206321993576.

Freeman, R. Edward, Robert Phillips, and Rajendra Sisodia. 2020. "Tensions in Stakeholder Theory." *Business and Society* 59(2). doi: 10.1177/0007650318773750.

Irawati. 2020. "Imunisasi Dasar Dalam Masa Pandemi COVID-19." *Jurnal Kedokteran Unila* 4(2).

Karen, and Susanti. 2019. "Teori Sinyal (Signalling Theory)." *Ekonomi* 1.

König, Pascal D., and Georg Wenzelburger. 2021. "The Legitimacy Gap of Algorithmic Decision-Making in the Public Sector: Why It Arises and How to Address It." *Technology in Society* 67. doi: 10.1016/j.techsoc.2021.101688.

Kujala, Johanna, Anna-Maija Lämsä, and Elina Riivari. 2017. "Company Stakeholder Responsibility." *Baltic Journal of Management* 12(2). doi: 10.1108/bjm-07-2016-0148.

Kujala, Johanna, Anna Maija Lämsä, and Elina Riivari. 2017. "Company Stakeholder Responsibility: An Empirical Investigation of Top Managers' Attitudinal Change." *Baltic Journal of Management* 12(2). doi: 10.1108/BJM-07-2016-0148.

Lelkes, Yphtach. 2016. "Winners, Losers, and the Press: The Relationship Between Political Parallelism and the Legitimacy Gap." *Political Communication* 33(4). doi: 10.1080/10584609.2015.1117031.

Miralles-Quirós, María Mar, José Luis Miralles-Quirós, and Jesús Redondo Hernández. 2019. "ESG Performance and Shareholder Value Creation in the Banking Industry: International Differences." *Sustainability (Switzerland)* 11(5). doi: 10.3390/su11051404.

Mohammad, Wan Masliza Wan, and Shaista Wasiuzzaman. 2021. "Environmental, Social and Governance (ESG) Disclosure, Competitive Advantage and Performance of Firms in Malaysia." *Cleaner Environmental Systems* 2. doi: 10.1016/j.cesys.2021.100015.

Nizam, Esma, Adam Ng, Ginanjar Dewandaru, Ruslan Nagayev, and Malik Abdulrahman Nkoba. 2019. "The Impact of Social and Environmental Sustainability on Financial Performance: A Global Analysis of the Banking Sector." *Journal of Multinational Financial Management* 49:35–53. doi: 10.1016/j.mulfin.2019.01.002.

Noorkusuma, Faridha K. 2017. "ANALISA KEBIJAKAN INTERVENSI POLITIK RUSIA DI WILAYAH CRIMEA UKRAINA (PADA MASA VLADIMIR PUTIN TAHUN 2012-2014)." *Universitas Muhammadiyah Malang*.

Novia. 2018. "Mengenal Teori Signaling Dalam Struktur Modal & Hubungannya Dengan Rasio Keuangan." *Jurnal.Id*.

Permatasari, Meirna Puspita, Ni Luh, and Putri Setyastrini. 2019. *Pengungkapan Tanggung Jawab Sosial Perusahaan Ditinjau Dari Teori Legitimasi Dan Teori Stakeholder*. Vol. 5.

Plastun, Alex, Inna Makarenko, Olena Kravchenko, Natalia Ovcharova, and Zhanna Oleksich. 2019. "ESG Disclosure Regulation in Search of a Relationship with the Countries' Competitiveness." *Problems and Perspectives in Management* 17(3). doi: 10.21511/ppm.17(3).2019.06.

Raimo, Nicola, Alessandra Caragnano, Marianna Zito, Filippo Vitolla, and Massimo Mariani. 2021. "Extending the Benefits of ESG Disclosure: The Effect on the Cost of Debt Financing." *Corporate Social Responsibility and Environmental Management* 28(4). doi: 10.1002/csr.2134.

Rizqi, Muhammad Nur, Yudiana Yudiana, and Tiara Damayanti. 2021. "Analisis Laporan Keuangan Dalam Mengukur Kinerja Keuangan PT Pembangunan Perumahan Tbk Periode 2015-2019." *Neraca Keuangan : Jurnal Ilmiah Akuntansi Dan Keuangan* 16(2). doi: 10.32832/neraca.v16i2.5492.

Setyahuni, Suhita Whini, and Rr Sri Handayani. 2020. "On the Value Relevance of Information on Environmental, Social, and Governance (ESG): An Evidence from Indonesia." *Journal of Critical Reviews* 7(12):50–58.

Sugiyono. 2019. *Metode Penelitian Kuantitatif, Kualitatif, Dan R&D*. 1st ed. Bandung: Penerbit Alfabeta.

Tarmuji, Indarawati, Ruhanita Maelah, and Nor Habibah Tarmuji. 2016. "The Impact of Environmental, Social and Governance Practices (ESG) on Economic Performance: Evidence from ESG Score." *International Journal of Trade, Economics and Finance*

7(3):67–74. doi: 10.18178/ijtef.2016.7.3.501.