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The Effect of Environment, Social, Governance (ESG) Score on the Performance of Banking Companies Listed on the Indonesia Stock Exchange

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ABSTRACT

The purpose of this research is to investigate how company performance is influenced by ESG disclosure. Using a sample of 10 companies in the financial sector listed on the Indonesia Stock Exchange for the years 2020-2023, the sample was selected using purposive sampling technique. The analysis technique used is multiple regression analysis and employs two control variables for financial performance measured by ROE and ROA, the dependent variable for company performance measured by Tobin's Q, and the independent variable measured by ESG score. The research results indicate that ESG disclosure impacts company performance. Further analysis reveals that the control variable ROA has a positive effect and the control variable ROE has a negative effect on company performance.

Keywords: *ESG, ROA, ROE, Tobin's Q*

1. Introduction

Each company is required to continuously develop to operate more effectively and efficiently in facing the increasingly tight business competition, in order to achieve the company's goals. In the research conducted by Apriada & Suardikha (2016), it is argued that improving company performance is used to optimize the welfare of each shareholder. The improving condition of the company can be described by the high level of the company's profitability, as it reflects the company's effectiveness in generating profit.

Global warming is the phenomenon of the increase in average temperatures of the atmosphere, oceans, and land, and it is one of the major issues currently facing the world. Long-term global warming can cause global climate change that can trigger forest fires, droughts, extreme weather changes, and prolonged dry seasons. The positive impact of global warming is that it has raised public awareness of the importance of environmental preservation and social responsibility. With the awareness of the community, investments based on Environmental, Social, and Governance (ESG) have become a trend in investing in recent years. Environmental controls how businesses operate and their impact on the environment; Social examines how companies treat people, relationships & employee diversity, health & safety while working; Governance looks at how companies can govern themselves. The next factor that can support the company's sustainability efforts is environmental investment. Environmental investment is an investment activity aimed at companies or potential investors who are committed to preserving natural resources, producing, and discovering alternative renewable energy sources that are friendly to the surrounding environment. (Rachman 2018). Green initiatives are defined as innovations in both software and hardware that are related to process or product innovations, product design, or business environment management, including technological innovations to save energy, prevent pollution, and recycle waste (Chen et al., 2014). The green initiatives implemented according to Yacob et al. (2020) are energy management, water conservation, and waste management.

This research aims to examine the impact of ESG disclosure on company performance. ESG disclosure in this study uses the ESG score issued by Bloomberg. Meanwhile, Tobin's Q, ROA, and ROE are taken from the Indonesia Stock Exchange.

2. Literature Review

2.1 Environmental, Social, and Governance (ESG)

Environmental, Social, and Governance (ESG) was first introduced by the United Nations Principles for Responsible Investment in the corporate social responsibility report (Nugroho & Hersugondo, 2022). These ESG aspects are essential to support economic, social, and environmental performance with the aim of achieving business sustainability. (Shakil, 2020).

The assessment of a company's environmental, social, and governance (ESG) is considered an important aspect in today's business world, used to evaluate the sustainability and social impact of investments in companies or businesses in the future. ESG is essentially a comprehensive framework that governs responsibilities related to non-financial aspects for an organization (Krishnamoorthy, 2021). ESG reflects practices used to measure, disclose, and hold accountable all stakeholders involved. (Almeyda & Darmansya, 2020). ESG involves various factors used to evaluate the non-financial impact of specific investments and companies. In addition, ESG also opens up various opportunities in the context of business and investment. (Gillan et al., 2021).

2.2 Environmental, Social, and Governance (ESG) Disclosure

The independent variable used in this study is ESG disclosure with the ESG disclosure score proxy issued by Bloomberg. The ESG disclosure score issued by Bloomberg ranges from 0-100. This score is developed using the Global Reporting Initiative (GRI) and Investor Stewardship Group frameworks. (ISG). There are three elements, namely the environmental, social, and governance elements. Then, each of these elements is assigned a weight of 33% each.

For the environmental element, the assessment topics include air quality, climate change, ecological impact, biodiversity, energy, materials and waste, supply chain, and water. For the social element, it consists of community and customers, diversity, ethics and compliance, health and safety, human resources, and supply chain. Meanwhile, for governance, it includes audit and negligence risk, board composition, diversity, independence, governance nomination and negligence, governance sustainability, and tenure.

2.3 Tobin's Q

Tobin's Q is one of the metrics for evaluating financial performance from an investment perspective, tested in various top management situations, and Tobin's Q is also a suitable indicator to be used as a measure of the company's economic performance. (Rengga & Sukmawati Sukamulja, 2013).

2.4 Hypothesis Test

Disclosure of non-financial information to stakeholders can encourage companies to increase profits, which can attract investors to invest in the company. (Atrianingsih & Nyale, 2022). In addition, the company uses additional financial information and ESG information as a means to achieve legitimacy with the community and all of the company's stakeholders. The company strives to disclose ESG information to enhance its working capital and operations. This is in accordance with the literature which states that ESG disclosure shows a positive impact on company performance, as evidenced by the research of Velte (2017), Buallay (2020), and Alareeni & Hamdan. (2020). From the description, it can be concluded that the form of the hypothesis is as follows:

H0: ESG Score does not affect company performance
H1: ESG Score positively affects company performance

3. Research Methodology

3.1 Population and Sample

The population of this research includes banking companies listed on the Indonesia Stock Exchange from 2020 to 2023, with a sample of 5 companies that have an ESG score.

This research uses the years 2020-2023 with the consideration that 2020 was the period of the Covid-19 pandemic, given that most companies were negatively affected by Covid-19, both financially and non-financially.

3.2 Research Variables

3.2.1 Dependent Variable

The dependent variable refers to a variable that is influenced by other factors, generally marked with the letter Y. The dependent variable can also be referred to as a bound variable, a non-free variable, or an endogenous variable. (Fauzi et al., 2020). In this study, the dependent variable is the company's financial performance measured by Tobin's Q.

3.2.2 Independent Variable

The independent variable is a variable that influences another variable, generally represented by the letter X. The independent variable is also known as the unbound variable, free variable, or exogenous variable. (Fauzi et al., 2020). The presence of independent variables can cause changes in the dependent variable, whether in an increase or a decrease. The independent variable used in this study is ESG disclosure. The ESG Score obtained from the independent agency Bloomberg.

3.2.3 Control Variabels

3.2.3.1 *Return on Assets* (ROA)

ROA is the ratio of net income to total assets to measure the rate of return on total investment (Rambe et al., 2015). The purpose of calculating this ratio is to determine the company's ability to use its total assets to generate net income after tax. There are two factors that influence Return on Assets, namely the turnover of operating assets and profit margin (Munawir, 2010). The higher the ROA ratio, the better the company manages its assets to generate net profit.

$$ROA = \frac{\text{Net Income}}{\text{Total Assets}}$$

3.2.3.2 *Return on Equity* (ROE)

ROE is a financial ratio used to measure a company's ability to generate profit after tax relative to the return on equity for shareholders. A high ROE ratio indicates that the company's ability to use capital is becoming more efficient and effective (Sudana, 2015). The measurement of ROE can be found by dividing the company's net profit after tax by the company's total equity.

$$ROE = \frac{\text{Net Income}}{\text{Shareholders' Equity}}$$

This research uses multiple linear regression data analysis techniques to determine the extent of the influence of independent variables on the dependent variable. (Ghozali, 2018). The regression model is used to make estimates regarding the relationship between one or more variables with known values and a variable with an unknown value. (Ningsih & Dukalang, 2020). Here is the equation of the multiple linear regression mathematical model using two control variables:

$$Y = \alpha + \beta 1X1 + \beta 2Z1 + \beta 3Z2 + e$$

Keterangan:

Y	= firm performance
α	= Constant
$\beta 1$, $\beta 2$, $\beta 3$,	= Regression slope coefficient
X1	= ESG disclosure
Z1	= Return on Assets

Z2 = Return on Equity
e = Error coefficient

3.2 *Descriptive Analysis*

Tabel 1
Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
X1_ESG	40	8	93	46,05	24,452
Z1_ROA	40	0,50	4,03	1,9587	0,89350
Z1_ROE	40	2,60	27,31	12,3567	6,17236
Y_TOBIN'S Q	40	0,37	1,65	0,9683	0,24405
Valid N (listwise)	40				

From the output results displayed in Table 1, it can be seen that the mean value of Y (Tobin's Q) is 0.9683 with a maximum value of 1.65 and a minimum value of 0.37. The standard deviation is 0.24405, lower than the mean value. Then, for the mean value of X1 (ESG disclosure) is 46.05 with a maximum value of 93 and a minimum value of 8. The standard deviation is 24.452, lower than the mean value of X1. For the control variable Z1 (return on assets), the mean value is 1.9587 with a maximum value of 4.03 and a minimum value of 0.50. The standard deviation of variable Z1 is 0.89350, smaller than the mean value. For the control variable Z2 (return on equity), the mean value is 12.3567 with a maximum value of 27.31 and a minimum value of 2.60. The standard deviation of variable Z2 is 6.17236, lower than the mean value.

4. Results

Here are the results of the moderation regression analysis:

Tabel 4
Hasil Regresi

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.	Collinearity Statistics Tolerance	Collinearity Statistics VIF
1	(Constant)	0,722	0,100		7,194	<,001		
	X1_ESG	0,004	0,002	0,426	2,226	0,032	0,598	1,671
	Z1_ROA	0,205	0,078	0,749	2,608	0,013	0,266	3,762
	Z1_ROE	-0,028	0,013	-0,717	-2,173	0,036	0,201	4,975

a. Dependent Variable: Y_TOBIN'S Q

Keterangan :

Y	= Firm performance
α	= Constant
β1, β2, β3, β4, β5, β6	= Regression slope coefficient
X1	= ESG score
Z1	= Return on Assets
Z2	= Return on Equity
e	= Error coefficient

The Influence of ESG Disclosure on Company Performance

The research results empirically support hypothesis one. When the disclosed ESG improves, the company's performance can also improve.The results of this study are not in line with the research by Fatemi et al. (2018), which states that ESG disclosure has a significant negative impact on company value. The explanation for these research results is that the market may interpret gradual ESG disclosure as an effort by the company to justify excessive investment in ESG activities.

Previous studies include Bashatweh et al (2023), Abdi et al (2021), Melinda & Wardhani (2020), Qureshi et al (2020), Handayati et al (2022), Fuadah et al (2022), and Yip & Lee. (2018). According to the research, ESG disclosure improves company performance. This finding supports the argument that there are two underlying relationships. (Bashatweh et al., 2023). Companies with good ESG performance and disclosure can predict future financial success and value, as ESG can incorporate ESG aspects into investment analysis and decision-making processes. ESG disclosure is also related to investors' investment decisions.

5. Discussion

The results of hypothesis H1 state that the ESG Score has a positive effect on Tobin's Q. In line with the research of Velte (2017), Buallay (2020), and Alareeni & Hamdan (2020), it is stated that management indicators impact company performance. With that information, the company can avoid the risk of losing market trust because management information related to the company's management activities is often hidden. By conducting ESG disclosure, companies also gain legitimacy from stakeholders due to their adherence to standards in corporate governance. The disclosure of ESG information analyzed in this study serves as an important indicator for long-term business sustainability, as the company's business will be more accepted and trusted by the market.

6. Conclusion

The purpose of this research is to analyze and test the influence of ESG score disclosure on company performance. In this study, company performance is measured by Tobin's Q. The research states that ESG Score disclosure has a positive impact on Tobin's Q with control variables ROA and ROE. The control variable ROA has a positive value, meaning that ROA has a positive influence on Tobin's Q; when ROA increases, Tobin's Q also increases. The ROE variable has a negative value, meaning that if ROE increases, Tobin's Q tends to decrease. This is because the company may not be making sufficient investments for growth, leading to a decrease in their Tobin's Q value. This research has several limitations that need to be considered. The limited sample size consists of only 40 data points from 10 companies over 4 years. The research focus is solely on the banking sub-sector, which does not encompass a broader variation of the industrial sector. Additionally, the research period is limited to the years 2020 to 2023. For future research, it is recommended to expand the sample by involving more companies and different industrial sectors, as well as extending the research period to obtain more comprehensive data.

Based on the conclusions and research findings, several implications for the company can be drawn, namely that the company needs to raise awareness of the importance of implementing ESG aspects in its operational activities and reporting. Compliance with ESG aspects has been proven to improve company performance in the long term. Companies should enhance the quality and quantity of information disclosure related to ESG performance in their annual and sustainability reports. This can increase investor confidence as well as the company's positive image. Management needs to consider ESG performance targets in the formulation of company strategies and decision-making. The implementation of ESG aspects must become an integral part of the company's strategy.

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