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Environmental, Social, and Governance (ESG) Disclosure Application to Company Profitability and Value

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Abstract

This study examined the impact of ESG disclosure implementation on manufacturing companies and their profitability, with capital structure as a mediating variable. This gap in research is due to several inconsistent findings with previous studies on the relationship between ESG disclosure and company performance, particularly in emerging markets like Indonesia. This study used quantitative analysis and PLS-SEM to examine 42 companies listed on the Indonesia Stock Exchange from 2018 to 2024. The results indicate that environmental, social, and governance disclosures positively affect company profitability, mediating the relationship between capital structure and ESG disclosure. These findings will contribute to understanding how ESG implementation affects company performance in emerging markets and provide practical insights for companies implementing ESG practices. These findings contribute to understanding the dynamics of ESG implementation in emerging markets, highlighting the influence of each ESG component on company performance. This study also emphasizes the importance of strategic alignment between sustainability initiatives and corporate financial management to optimize performance in the face of the ever-changing business landscape in Indonesia.

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INTRODUCTION

Development is accelerating in the age of globalization. Business is complicated and dynamic, and concerns about governance, society, and the environment have drawn the attention of stakeholders, including investors, regulators, and the general public. Growing knowledge of stakeholders' interests requires the Company to Consider environmental, social, and governance issues in addition to profit-making concerns due to the effects of the operational Company's activities (Atan et al., 2018).

Environmental, Social, and Governance (ESG) is a comprehensive valuation model used to evaluate the performance of a company's related impact on the environment, responsibility answers, and social and governance companies as a consequence of activity company operations. This ESG aims to balance efforts to maximize the profit of the Company while still making a positive contribution to society and the environment (Silva et al., 2024). Companies that implement ESG principles can excel and provide long-term terms for stakeholders' interests, with methods aligned between goals – economic and social goals (Li, 2024). In addition, companies that focus on implementing ESG principles are driven To carry out various ongoing programs, which not only strengthen the image of the Company in the eyes of the public but also increase non-financial performance overall (Radhakrishna & Lappay, 2024).

Based on the report (Bappenas, 2021), the targets of Sustainable Development Goals (SDGs) are to reach a growth sustainable economy, sustainably improve the welfare public, build strong partnerships between various stakeholders' interests, increase the protection of the environment For ensure that source Power natural used in a way responsible answer, and ensure that development inclusive, equitable and sustainable For all. Concept disclosure Environmental, Social, and Governance (ESG) is carried out by the Company as a form of commitment to the company practice of ethical and sustainable business. This ESG disclosure helps stakeholders' interests in making the right decisions, handling, and reporting policy-related environment, social, and corporate governance. In addition, it has raised awareness from the community, regulators, and investors of the importance of implementation disclosure of Environmental, Social, and Governance (ESG) (Veeravel et al., 2024).

To realize financial program success sustainability, the government has published Regulation Financial Services Authority Number 51/POJK.03/2017 concerning implementing Finance sustainability for Financial Services Institutions, Issuers, and Public Companies. With the existence of regulations that require the compilation reports to be sustainable, it is expected that the report will announce to the Community loading performance of the economic, financial, social, and environmental life of a Financial Services Institution, Issuer, and Public Company in carrying out sustainable business (Financial Services Authority, 2018). Unlike developed countries, Indonesia is still at the stage early in the journey of ESG investment. Implementing Environmental, Social, and Governance (ESG) in Companies is still considered a cost, not an investment, which creates a pull stretch between financial profit and ESG impact (Mandiri Institute, 2022). Still, there are doubts about the Company's ability to implement ESG disclosure comprehensively.

Based on the problem mentioned, the formulation problem studied in the research is How to influence Implementation Disclosure of Environmental, Social, and Governance (ESG) towards Company value and profitability through the capital structure as variable mediation. In addition, research tries to fill in the gap by contribution. First, research carried out in Indonesia, a developing country still at the stage of beginning implementation of ESG, can give a perspective on the dynamics of ESG implementation in emerging markets. Second, the research uses an approach with separate analysis of ESG (environmental, social, governance) components to understand contributions specific to each dimension. Third, 2018-2024 observations include a critical phase in developing ESG regulations and practices in Indonesia, including issuing POJK 51/2017 concerning financial sustainability. Fourth, the sample covers companies from various sectors, allowing analysis across the comprehensive industry. Thus, research is expected to better understand the effectiveness of ESG implementation in the context of emerging markets like Indonesia.

For that, the study aims to analyze deep Implementation Disclosure of Environmental, Social, and Governance (ESG) towards Company Value and Profitability in Indonesia with Capital Structure As a variable mediation in Companies Listed on the Indonesia Stock Exchange for the 2018 – 2024 Period. In addition, the research is also expected to benefit the perpetrator business and parties related to understanding factors that influence sustainability business.

METHODS

This is a Research Method Quantitative, where method study quantitative is method research that refers to philosophy positivism, intended for researching population and sample certain, using instrument research in data collection, data analysis is statistics for do testing to the hypothesis that has been formulated previously (Sugiyono, 2013).

Study This uses numeric data To evaluate the environment, social, and governance scores to mark the Company and profitability. Types of data used in the study This is secondary data, where secondary data is obtained in a way that is not direct through other parties (Amruddin et al., 2022). The secondary data used in this study Was obtained from a report published by Bloomberg

Study This will carried out in companies all over sector in Indonesia. Based on the results of the study, these companies all over the industry in Indonesia are expected to implement disclosure of environmental, social, and governance (ESG) and become accurate representations for similar studies later. Population research that will be used in research is companies listed on the Indonesia Stock Exchange from 2018 to 2024. Based on data obtained from Bloomberg, 915 companies in Indonesia are in 11 sectors.

The criteria used are: For choosing a Company as the sample companies that have conducted an Initial Public Offering (IPO) in 2018; the Company that issued a report finance in a way periodic during the period 2018 to 2024; and consistent companies publish ESG Scores in the Bloomberg database throughout the period 2018 to 2024. Based on the criteria, the research will use a sample study approach. This consists of 42 companies from the nine sectors in Indonesia.

Retrieval sample in research This is done using the purposive sampling method. Forty-two samples will be used in the research. Where is this application of the causality model, or can it be interpreted as a connection influence between variable study through testing hypothesis so that study This various explanatory (explanatory research) (Sugiyono, 2013)? For that, research Focuses on confirming the theory of object study, both in explanation and prediction.

Measurement based on existing literature established and accepted metrics in a standard way in research finance. Bloomberg's ESG scores provide size standards across-the-board companies, while ratio finance is counted using data from report finances that have been audited. This ensures reliability and comparability measurement across the board sample.

Study This uses Partial Least Squares Structural Equation Modeling (PLS-SEM) to analyze data and test hypotheses. PLS-SEM was selected. Because of its ability to handle complex models with multiple constructs and relationships, as well as its ability to accommodate size relative to sample (Hair et al., 2022).

Data analysis using PLS-SEM was carried out through two main stages. Stage First is the evaluation of measurement models (outer model), which assesses the reliability and validity of construct research. Stage second is structural model evaluation (inner model) that tests the model's connection between construct and significance path (Hair Jr et al., 2023). In the review of the measurement model, the study evaluates reliability indicator through outer loading with a minimum threshold of 0.7, internal consistency reliability through composite reliability with a minimum threshold of 0.7, convergent validity through average variance extracted (AVE) with a minimum threshold 0.5, and discriminant validity through criteria Fornell-Larcker and cross-loadings (Hair Jr et al., 2021). Evaluation of the structural model is done by evaluating coefficient determination (R^2), effect size (f^2), predictive relevance (Q^2), and path coefficients. The R^2 value indicates the ability to predict the model, with criteria 0.75 (substantial), 0.50 (moderate), and 0.25 (weak). Effect size f^2 assesses the impact substantive variable independent, with criteria 0.35 (large), 0.15 (medium), and 0.02 (small (Hair Jr et al., 2023).

To overcome the potential multicollinearity problem, research Evaluates the Variance Inflation Factor (VIF) with a maximum threshold of 5.0. VIF values exceeding the threshold indicate problem multicollinearity that requires model adjustment or deletion indicator (Hair et al., 2022). Heteroscedasticity is overcome by applying consistent PLS bootstrapping with 5000 resamples to produce robust standard errors. The procedure Ensures reliable results in testing the hypothesis, although there is heteroscedasticity in the data (Hair Jr et al., 2023)

The hypothesis was tested through a bootstrapping procedure with 5000 resamples to evaluate significance statistics from path coefficients. The criteria reception hypothesis is based on the t- t-statistic value >1.96 (two-tailed) and p-value <0.05 at the level of 95% confidence (Hair et al., 2022). For the hypothesis involving effect mediation, the research applies procedure analysis of mediation-specific indirect Effects with the bootstrapping approach. Significance effect mediation rated through bootstrap confidence intervals, where the intervals do not cover zero, indicates significant mediation (Hair et al., 2022).

The overall model fit is evaluated using standardized root mean square residual (SRMR) with a threshold <0.08 and normed fit index (NFI) with a threshold >0.90 (Hair Jr et al., 2023).

RESULTS AND DISCUSSION

Our PLS-SEM analysis revealed a complex relationship between component implementation disclosure Environment, Social and Governance (ESG), capital structure, value companies, and profitability in companies listed in Indonesia. As for Figure 1, it presents the results of Partial Least Squares Structural Equation Modeling (PLS-SEM).

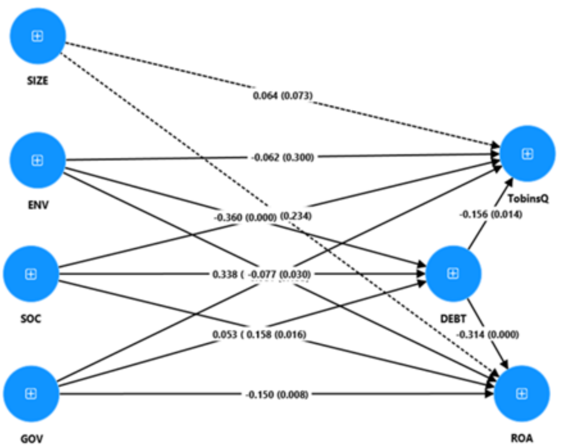

Figure 1. PLS-SEM Results

Research results is shown in Table 2 for test influence Implementation Disclosure Environmental (ENV), Social (SOC), and Governance (GOV) on Company Value and Profitability, as well as role mediation Capital Structure in Relationship in companies listed on the Indonesia Stock Exchange during the period 2018–2024.

In testing influence direct to mark company, it found that disclosure environment (H1) had no own influence significant against

Table 1. Test Results Hypothesis

Path	Coefficient (β)	p-value
Panel A: Direct Effects on Tobin's Q		
ENV → Tobin's Q	-0.077	0.501
SOC → Tobin's Q	0.141**	0.041
GOV → Tobin's Q	-0.066*	0.077
Panel B: Direct Effects on ROA		
ENV → ROA	0.091	0.328
SOC → ROA	0.164**	0.027
GOV → ROA	-0.158***	0.009
Panel C: Indirect Effects through Capital Structure (DEBT)		
ENV → DEBT → Tobin's Q	0.025	0.135
SOC → DEBT → Tobin's Q	-0.043*	0.086
GOV → DEBT → Tobin's Q	0.003	0.693
ENV → DEBT → ROA	0.066***	0.005
SOC → DEBT → ROA	-0.110***	0.000
GOV → DEBT → ROA	0.009	0.648

Note: *** , ** , * *indicates significance at 1%, 5%, and 10% levels respectively. ENV = Environmental Disclosure; SOC = Social Disclosure; GOV = Governance Disclosure; ROA = Return on Assets; Tobin's Q = Market Value/Book Value of Assets.*
Source: Processed Data, 2024

Tobin's Q (β = -0.077, p = 0.501), p This is in line with the study (Aydogmus, et al., 2022). Temporarily, disclosure social (H2) shows a positive influence (β = 0.141, p = 0.041), supporting findings previously about the role of disclosure social in improving the reputation of the Company (Aydogmus, et al., 2022). Governance Disclosure (H3) shows influence negatively significant at the 10% level (β = -0.066, p = 0.077), different from the previous study, which found influence positive.

Related influence to profitability, disclosure environment (H4) No show significant influence on ROA (β = 0.091, p = 0.328), contradictory with findings (Clarkson et al., 2011). Disclosure of social (H5) own influence positive significant (β = 0.164, p = 0.027), consistent with the study (Qiu et al., 2016). At the same time, Governance disclosure (H6) shows influence negatively significant (β = -0.158, p = 0.009), different from the results of the study previously found connection positive.

It was discovered that capital structure had no mediating effect on the disclosure environment to Tobin's Q (H7), β = 0.025, p = 0.135 when the effect of mediation capital structure was tested. At the 10% level (H8), however, capital structure substantially impacts social disclosure against Tobin's Q (β = -0.043, p = 0.086). Against Tobin's Q (H9), capital structure does not mediate governance disclosure (β = 0.003, p = 0.693). Additionally, it has been demonstrated that the capital structure mediates positively significant disclosure environment on ROA (H10), β = 0.066, p = 0.005, and negatively significant disclosure social on ROA (H11), β = -0.110, p = 0.000. Nevertheless, mediation capital structure had no discernible impact on influence governance disclosure on ROA (H12), with β = 0.009 and p = 0.648.

This explanation is necessary for the complex connection between ESG practices, capital structure, and performance companies in capital markets. Research results show that

No ESG dimensions have the same impact on the performance of the Company, which indicates the need for more approach nuances in the implementation of ESG practices.

Dimensions have been socially proven to be the most influential factor in increasing company performance, good-from-side profitability, and market value. This strengthens the argument (Deegan, 2002) that disclosure of good social can build trust in stakeholders' interests and improve the reputation of the Company. Implications in practice include the Company's need to pay attention to the social aspect of its sustainability strategy, including welfare employees, engagement in society, and social inclusion.

Interestingly, the environmental dimensions significantly and directly influence the Company's performance. However, its impact is positive when mediated by capital structure. Findings This develops understanding (Clarkson et al., 2011) and shows that the benefit disclosure environment is Possible. It is not quickly seen in performance finance but can come properly through more access to source funding and optimization capital structure. Contradictory results on the governance dimension, where there is a negative influence on profitability, raise questions about the trade-off between good governance practices and efficient operational terms. Different from the findings (Bhaskaran et al., 2020), this possibly indicates that strict governance implementation can cause significant compliance costs in the long term, though potentially beneficial.

The role of mediation capital structure in research gives a new perspective on how ESG practices can influence a company's performance. In line with (Fatemi et al., 2018), findings show that the benefits of ESG practices can be realized by optimizing capital structure. However, the connection is not always linear or positive For all ESG dimensions. Implications are theoretical from the study. There is a need to develop a framework for understanding the connection between ESG, capital structure, and a company's performance. While those implications in practice lead to the importance of a more strategic and integrated approach in implementing ESG practices, considering the role of capital structure as a transmission mechanism is important.

CONCLUSION

Research study discloses several significant findings about the connection between ESG practices, capital structure, and company performance. First, disclosure of social proof becomes key to improving Mark's Company's profitability, showing the importance of social media in the sustainability strategy of the Company. Second, although the disclosure environment has no significant direct impact, its influence can be optimized through management's effective capital structure. Third, disclosure of governance shows complex impacts, with influence negative to profitability term short as possible reflect cost significant compliance.Proven capital structure plays an important role as a mediator in the relationship between ESG practices and performance companies, particularly for environmental and social dimensions. Findings This confirms that the implementation of ESG practices is necessary to consider the aspect of funding and capital structure as mechanism transmission that can influence the effectiveness of ESG practices in improving company performance.

It is recommended that management companies adopt a more integrated approach to implementing ESG practices, considering the role of capital structure as an enabler factor. Companies need to focus specifically on proven social impact that is positively and directly correlated to performance while optimizing the practice environment and governance through effective capital structure management. For investors and analysts in finance, a results study Is recommended, considering the interaction between ESG practices and capital structure in the evaluation performance of a company. Approach further evaluation comprehensively, which includes the second aspect. This can better understand prospects and the Company's long-term prospects.

For study Next, it is recommended to expand analysis with contextual factors like industry, cycle business, and conditions macroeconomics that can influence ESG practices' effectiveness. Research continuation can also explore mechanism alternatives besides capital structure that can mediate the connection between ESG practices and performance companies, as well as do longitudinal analysis to understand the impact of the implementation of ESG practices.

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