The Impact of ESG Practices on Sustainable Companies Performance in Indonesia

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ABSTRACT

ESG practices aim to minimize a company's risks by caring about environmental, social, and governance aspects. Implementing ESG practices certainly has benefits for companies, namely improving the company's reputation. This research aims to measure the ESG practices of Indonesian companies listed on the Indonesian Stock Exchange. The research analysis uses the panel regression method. Previous researchers faced limitations in studying companies implementing ESG, leading to a limited number of analyzed companies. Therefore, using data obtained from Tobin's Q can distinguish this study. Based on the data processing results, environmental and ROA variables significantly positively impact the company's performance or reputation. However, social and governance variables do not influence the company's reputation, possibly due to various factors causing companies to focus less on the performance of these two variables.

INTRODUCTION

In recent years, the global community's attention to sustainability factors in the business world has increased. The sustainability can describe innovative thinking that aims to bring about change by integrating climate, economic and ethical considerations (Darsono et al, 2022). There are three aspects of sustainability that are considered, including Planet, People and Profit. The impact of this turns out to have a broad influence on all sectors, one of which is the company's financial system. So in operational practice a company must pay attention to the impacts that occur as a result of its business activities, but not only think about the company's income but the impacts that have on several stakeholders. Based on the corporate point of view, social and
environmental concerns are often companies that perform better so that they have the potential for faster growth. (Siming Chen et al. 2023).

Running a sustainable company is certainly a long-term investment. Sustainable investment is an ethical and environmentally friendly practice that can be measured using ESG investment, or socially responsible investment (Tseng et al, 2019). Indonesia is one of the countries that is committed together with other countries to support and contribute to sustainable achievement on a global scale, namely by marking the existence of Sustainable Development Goals (SDGs). Therefore, the government has established policies regarding the implementation of sustainable financial practices for financial service institutions, issuers and public companies (OJK, 2017). The aim of determining and implementing sustainability is to achieve development, so the regulation states that in implementation companies or financial services institutions have an obligation to carry out reporting regarding the company's sustainability performance and the impacts it causes.

Evidence of a company implementing a sustainable business is characterized by the existence of an ESG framework. ESG practices are an activity that aims to minimize a company's risks by caring about three aspects including environmental, social, and governance. According to Tseng Ming Lang et al (2019) in their research explained that sustainable investment has the potential to have a positive impact on sustainable growth through a combination of social, environmental and economic impacts. Implementing ESG practices certainly has benefits for companies, namely improving the company's reputation. With this implementation, it is very easy for companies to attract investors and vice versa, investors will easily find out about companies that have implemented ESG by looking at and considering company reports. In managing its business, the company really wants to achieve superior performance. This achievement is closely related to operational business processes in an industry. The company's performance in this situation can be used as an assessment material for the company to find out how the performance has been created so far and the company's ability to handle the available resources. The establishment of a good company does not only focus on financial reports, but corporate management sustainability reports are an important concern for growing the company's reputation (Tarmuji, 2016).

To analyze corporate sustainability practices several researchers have contributed based on their findings. According to research on the influence of ESG on corporate finance which was analyzed on western European companies, ESG practices had significant negative results on company performance as measured by return on assets (ROA), but ESG had a positive influence on revenue. This can be concluded that
customers are more interested in companies that invest in ESG (Zahid et al, 2022). Furthermore, according to Safriani and Utomo (2020), their findings explain that ESG has a significant effect on financial and operational performance.

After knowing the value of implementing ESG in several countries, this research will analyze ESG practices in Indonesian companies. Apart from that, this research is able to determine the influence of ESG practices on company reputation. The aim of this analysis is to assess the extent to which companies in the country pay attention to ESG factors in their operations. The research sample includes 33 companies that implement ESG practices and are listed on the Indonesia Stock Exchange (BEI). The contribution to this research is that a study will be carried out on company sustainability reports which will be measured using ESG reports and indicators for measuring company performance, namely using Tobin’s Q or company ratios. Tobin's Q is used as a model that serves as a measurement of green companies, and capital from investment (Faria et al, 2022). These data will be analyzed to identify the ESG practices implemented by the company. Next, the impact of ESG practices on company performance will be evaluated. If the company has good performance, it will provide good trust, confidence and support (Apriyana, 2017). Companies that have good performance will have an impact on increasing profits for the company.

LITERATURE REVIEW
Sustainable Company

Implementing sustainability has now become a trend in companies. Even the Indonesian government directed all companies to implement this. Sustainability in companies pays attention to three aspects including environmental, social and governance. Implementing sustainability in companies can increase the high level of trust in a company so that several stakeholders can be interested in making investments, investing, and so on. Currently, stakeholders assess that maximizing corporate sustainability involves business factors including environmental, social and governance (Elkington, 1999). Therefore, implementing sustainability can increase company resilience.

Environmental, Social and Governance (ESG) Practices

ESG practices have been implemented since 1970, when investors showed concern in reporting a company's social and environmental practices (Ricardson, 2009). This was followed by the determination of responsible investment by the PBB around 2006. So this issue was appointed as one of the decision-making factors regarding cooperation carried out by companies.

ESG practices are three important things reported by companies. This reporting is an ideal indicator in managing risk management, financial and non-financial performance, as well as management competence (Galbeath, 2013). The three main
aspects of ESG include issues related to environmental management such as energy and water, protection of natural resources, emissions. Meanwhile, the social aspect pays attention to human rights responsibilities, fair business principles, product safety and gender equality. Governance refers more to the company's internal affairs which pay attention to company leadership, company control, shareholder protection (Zahid, 2020).

**Company Reputation**

A company's performance can be seen from its company reputation. Implementing sustainability can have an impact on the image of a company. A company's reputation can influence various aspects of business which can increase customer trust, consumer influence, attract investors, brand value and customer loyalty. Company reputation plays an important role that can influence the company's sustainability in the long term. Companies must not only pay attention to profits or seek personal satisfaction but must pay attention to other parties who are factors in business continuity (Nelson, 1959; Aghion & Howwit, 1992). Thus, companies must manage their business by paying attention to ethical business practices.

**METHOD**

**Data**

This research uses quantitative analysis which aims to identify ESG practices by measuring Environment, Social and Governance on company reputation. The sample used in the research was 33 Indonesian companies listed on the Indonesia Stock Exchange (BEI) which had ESG score. This research used annual data from 2018 – 2020. Data was obtained from the Thomson Reuters Eikon device or called Revinitiv. By obtaining ESG reports from Indonesian companies, the implementation and optimization of the results will be examined. This analysis will be linked to the company's financial reports so the analysis of the company's performance can be obtained after implementing ESG practices. The ESG value is in the form of an ESG report, each variable has its own value. Meanwhile, financial reports were obtained from the company's annual financial reports.

Company performance can be obtained using Tobin’s Q ratio. Thus this research used Tobin’s Q as the dependent variable (Safriani et al, 2020). This research aims to examined whether the independent variables influences the assets of companies which implement ESG. Tobin’s Q is closely related to green companies or sustainable companies. In this case Tobin’s Q should reflect the size of the green company (Faria et al, 2022). By knowing its connection to ESG, companies can consider market sentiment. The model for finding the Tobin’s Q value can be calculated by:

$$Q = \frac{(MVE + DEBT)}{TA}$$
Note:
MVE = Market Value/Equity of outstanding shares
DEBT = Liability Value
TA = Total Asset Value

Research Model
From the data obtained, models include:
\[ \text{COMP}_{i,t} = \beta_1 \text{ENV}_{i,t} + \beta_2 \text{SOC}_{i,t} + \beta_3 \text{GOV}_{i,t} + \beta_4 \text{ROA}_{i,t} + e \]

Note:
COMP = Company Performance
ENV = Environment Score
SOC = Social Score
GOV = Governance Score
ROA = Return on Asset
e = Error

The independent variables used in this research such as Environment, Social, Governance (ESG Score) and ROA. The Returns on Assets variable is used as a benchmark for financial reports to answer whether the profits generated can increase when the company implements ESG performance. Meanwhile, the ESG variable is a variable that cannot be separated to measure and analyze sustainability. However, to measure a company's reputation, it uses Tobin’s Q which is used as the dependent variable.

Previous research only measured using the Tobins'Q model which functions to assess traditional companies and investments with a smaller sample of companies (Faria et al, 2022). Meanwhile, this research uses panel data regression to examine cross section and time series data from 33 companies. Panel data testing shows that a good estimate is considering time and cases simultaneously to contain more information and make time series observations more efficient (Gujarati et al, 2017). The modeling used includes Poled Least Square (PLS), Fixed effect model, Random Effect. The best model is a model that is able to interpret the analysis with a smaller Ho probability value. This regression aims to test independent variables on company performance.

RESULT AND DISCUSSION
RESULT
Results obtained after combining all variables over a period of 3 years. This research also tests the data with the aim of checking whether the data can be analyzed further. Table 1 shows details of each variable regarding the average, standard deviation, minimum and maximum numbers.
Table 1. Descriptive Statistics

<table>
<thead>
<tr>
<th>Variabel</th>
<th>Average</th>
<th>Std.Dv</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tobin’s Q</td>
<td>0.57</td>
<td>0.19</td>
<td>0.15</td>
<td>0.89</td>
</tr>
<tr>
<td>Environment</td>
<td>41.45</td>
<td>21.09</td>
<td>3.87</td>
<td>79.5</td>
</tr>
<tr>
<td>Social</td>
<td>41.45</td>
<td>22.99</td>
<td>12.16</td>
<td>93.96</td>
</tr>
<tr>
<td>Govenance</td>
<td>0.58</td>
<td>24.16</td>
<td>2.98</td>
<td>93.73</td>
</tr>
<tr>
<td>ROA</td>
<td>5.18</td>
<td>4.77</td>
<td>0.12</td>
<td>29.10</td>
</tr>
</tbody>
</table>

Source: Data analysis, 2023

Based on the analysis that has been carried out, the average company reputation is 0.58. Meanwhile, the highest reputation value was 0.89, namely companies engaged in mining. Companies that have the highest value for environmental practices are those that operate in finance such as banking, while the highest social practices are financial and mining companies.

Table 2 presents regression results using panel data. The results are estimates from PLS, Fixed Effect and Random Effect. The results obtained from these three Fixed Effect tests were chosen as the best tests based on the Hausman test and Chow test.

Table 2. Panel regression results

<table>
<thead>
<tr>
<th>Variable</th>
<th>PLS</th>
<th>Fixed Effect</th>
<th>Random Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>ENV</td>
<td>-0.152</td>
<td>0.138***</td>
<td>-0.047</td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
<td>(0.053)</td>
<td>(0.261)</td>
</tr>
<tr>
<td>SOC</td>
<td>-0.0735</td>
<td>0.130</td>
<td>-0.016</td>
</tr>
<tr>
<td></td>
<td>(0.113)</td>
<td>(0.250)</td>
<td>(0.187)</td>
</tr>
<tr>
<td>GOV</td>
<td>0.099</td>
<td>0.124</td>
<td>0.003</td>
</tr>
<tr>
<td></td>
<td>(0.004)</td>
<td>(0.102)</td>
<td>(0.158)</td>
</tr>
<tr>
<td>ROA</td>
<td>-0.091</td>
<td>0.075***</td>
<td>(0.005)</td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
<td>(0.0343)</td>
<td>(0.442)</td>
</tr>
<tr>
<td>R-Square</td>
<td>0.042</td>
<td>0.116</td>
<td>0.971</td>
</tr>
<tr>
<td>Chow Test</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hausman Test (Chi2)</td>
<td></td>
<td></td>
<td>58.67***</td>
</tr>
</tbody>
</table>

Notes: ***, **, * indicate significant variables of 1%, 5% and 10%

Source: Data analysis, 2023

DISCUSSION

The influence of the environment on company reputation

Based on the analysis that has been carried out, the influence of the environment on a company greatly influences its reputation. In this analysis, Environment is the main independent variable, getting significant positive results. Specifically, this means that every 1% increase in environmental management carried out by the company is
estimated to increase the company's reputation by 0.13 points. These results are the same as research conducted by previous research on Western European companies (RM Ammar Zahid et al, 2022) which revealed that environmental results were significant and argued that ESG values had a big influence on companies. Therefore, there will be a withdrawal of investors. In addition, the results of research conducted by Alareeni et al (2020) show that the relationship between environment has a significant positive effect on corporate reputation. The difference in results obtained from research conducted by Abughniem et al (2020), in his research entitled the influence of ESG on company performance shows significant negative results.

Social Influence on company reputation

Meanwhile, social variables show no influence on company reputation. In contrast to the analysis of Malaysian companies, researchers suggest increasing the female workforce so that there are no gaps. This is a form of social practice that pays attention to employment (Zahid, 2018). The factor why companies pay less attention to social values is perhaps if seen from the employment aspect, companies prefer employees who have good skills without paying attention to gender. Apart from that, why companies don't focus on social practices, maybe stakeholders are very strict in managing the company so there is a lack of knowledge that social values had a positive influence. The positive effect is also obtained from the results of research by Chen Simin et al (2023) in their findings explaining that reduced asymmetric information and market volatility are shown by strong ESG performance so that it can reflect social responsibility. Then research was also conducted by Saputri et al (2022) explaining that social responsibility has a significant positive effect on corporate awards or corporate reputation.

The influence of governance on company reputation

Likewise, with social variables, governance variables do not affect a company's reputation. Governance is an ESG practice that focuses on company management and aims to understand company operations. Governance should be the main factor that companies pay attention to because the good and bad of a company are closely related to the ethics of the company's operational practices. It is possible that governance does not have positive results in this analysis because most companies have good organizational practices but are hampered by standard governance measurements on ESG practices. Some of the companies included in the study are large companies whose success will certainly be close to good operational practices. Similar results were also obtained from the research of Ghazali et al. (2020), which found that the hypothesis was rejected so that there was no effect on governance with corporate reputation. In contrast to the results of research that has been conducted and previous studies based on
Norfrianti et al.'s research (2020) shows that corporate governance significantly positively affects a company's reputation; this can be proven when employees can contribute and maintain it.

**The influence of ROA on company reputation**

Return on Assets is a ratio that measures a company's ability to manage assets and generate profits. The research results show that ROA has a significant positive effect on a company's reputation. This means that every 1% increase in profits will increase the company's reputation by 0.075 points. Like the formula for determining reputation, which is assessed using Tobin's Q total assets, it is very influential in getting high reputation results. The significant ROA results show that the company can generate profits with good asset management, which can increase stakeholder trust. Then, a high ROA is the key to the company's long-term term because good asset management will produce stability and sustainability in company practices. However, there is a difference with previous research; based on the results of the relationship between ROA and the company, it is inversely proportional to getting a negative value; researchers emphasize that the higher the level of disclosure of ESG, GSR, and EVN will affect ROA and ROE to increase (Alareeni et al., 2020). The study also found significant positive ROA, equity debt, and current ratio on company reputation (Juwita, 2019). ESG considerations, in general, have a positive significant impact if practiced so that it can affect ROA in each company, which can improve the company's reputation (Suttipun, 2023).

**CONCLUSION**

Based on the analysis carried out, two variables, namely the environment and Return on Assets, have a positive effect on the company's reputation. While governance and social variables have no influence, there may be other things in company practices that cause this value to decrease. Therefore, by knowing the significance of what has been done, we can find out the extent to which Indonesian companies implement optimal ESG practices for the sustainability of the company and its stakeholders.

This research explains how ESG affects company reputation. Of the three ESG variables, several companies have not implemented them optimally. So this is a limitation for researchers who cannot know which companies have low ESG influence. Therefore, it is recommended for future researchers to use other methods to assess the influence of ESG on company reputation in order to find out what types of companies are lacking in implementing sustainability.
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