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ESG AS AN IMPORTANT FACTOR OF COMPANY PROFITABILITY AND AS A MODERATION OF CORPORATE VALUE

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Abstract:
Environmental, social, and corporate governance (ESG) aspects are crucial for investors. This is related to the company's efforts to participate in protecting the environment to achieve sustainability. The ESG aspect is expected to increase profitability, which can affect company value later with ESG. This study analyzes whether ESG can affect company profitability and firm value and moderate profitability to firm value. Samples were selected using a purposive sampling technique, which was then analyzed using linear regression. The research object is a company listed on the Indonesia Stock Exchange from 2016 to 2021 that already has an ESG score, the data of which was obtained from Bloomberg. The results showed that ESG did not affect profitability and firm value; profitability significantly affected firm value, and ESG could not moderate profitability. The results of this study have implications that ESG aspects need to be aligned with company goals, and improvements to all ESG aspects also need to be made. ESG is not only carried out to fulfill regulatory requirements.

Keywords: ESG, profitability, the value of the company, sustainability

INTRODUCTION

Recently, people worldwide have seen that the economic activities carried out have caused environmental damage. This can be seen in various disasters because of climate change. Floods, prolonged droughts, landslides, and unhealthy air are the impacts produced by climate change. Climate change is caused by economic activities not paying attention to the environment. As Drews and van den Bergh's (2017) econ mentioned, omic development is a tradeoff between development and economic preservation efforts. Economic development that does not pay attention to the environment will have negative impacts in the future for nature and humans.

The issue of climate change is increasingly becoming an attraction for research because, based on Ahdiat (2022), Indonesia's environmental conservation is classified as poor on a global scale, even on the Asia Pacific scale. Indonesia is ranked 164th out of 180 countries researched by the Environmental Performance Index 2022 (EPI). In addition, problems of environmental degradation, such as resource depletion, carbon pollution, climate change, and a decline in biodiversity, leading to a decline in ecological balance, have occurred almost all over the world (Yildiz et al., 2019). Therefore, economic development must always maintain environmental sustainability.

Various parties have taken action to prevent environmental damage. Even at the G-20 meeting in Bali in 2022, three issues related to the environment were raised, namely supporting sustainable environmental restoration. Second, ecosystem management on land and sea should be encouraged. Third, resource mobilization should be encouraged to protect the environment and control climate change (Gandhawangi, 2022). The government has asked various parties, including companies in Indonesia, always to pay attention to the environment.

To realize a national economy that grows stably, inclusively, and sustainably with the ultimate goal of providing economic and social prosperity to all people and protecting and managing the environment wisely in Indonesia, the economic development process must prioritize the harmony of economic, social and environmental aspects. The Financial Services Authority, as a regulator in

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the capital market, has issued Financial Services Authority Regulation Number 51 of 2017 concerning the implementation of sustainable finance to ensure that companies have awareness or commitment to the implementation of sustainable finance principles, contribute to the development of products in the form of goods and services that consider economic aspects, social, and environmental. Based on this regulation, companies are required to prepare sustainability reports.

Implementing sustainable finance is expected to continue providing economic benefits for companies, maintaining and increasing their profitability and company value. The application of sustainable finance for companies is more directed towards implementing ESG (Environment et al.). According to Satito (2023), ESG is a concrete follow-up to efforts towards SP in a company. ESG is more likely to look at company performance by considering environmental, social, and risk criteria through its governance.

Reliable, trustworthy, and relevant ESG disclosures are critical for investors' decision-making. Therefore, investors encourage companies to devote more resources to producing ESG reports to meet investors' needs (Wong, 2017). The Global Reporting Initiative (GRI) Index has become a guide for companies in compiling their sustainability reports in addition to the ISSB standards. After IFRS S1 and S2 are published, sustainability reports will become standardized for all companies that adopt IFRS in the future.

Investors are currently more interested in companies that have implemented ESG thoroughly. Clark et al. (2014) stated that companies implementing ESG will produce better operational performance and increase share price performance. Then, Cakranegara and Sidjabat (2021) stated that companies implementing ESG will increase the company's competitive advantage, which will ultimately increase company value. Triyani et al. (2020) and (Titman et al., 2018) stated that one aspect of financial performance that is important for investors is the company's ability to generate profits. Good financial performance will give investors hope to invest, increasing share prices. Implementing ESG by existing regulations will increase the company's credibility. Revenue growth depends on improving the company's image and customer trust, which influences the acquisition of loyalty to the company (Safriani & Utomo, 2020), (D'Amato et al., 2023).

Various previous studies have examined applying sustainability reports to profitability and company value. Research from Buallay (2019) and López-Toro et al. (2021) said that environmental scores influence profitability. However, research from Alareeni and Hamdan (2020) and Atan et al. (2018) says the opposite result. Then, Buallay (2019), Li et al. (2018), Alareeni & Hamdan (2020), and López-Toro et al. (2021) in their research produced the finding that environmental scores have a positive effect on company value. On the other hand, research by Balasubramanian (2019) also shows that there is a negative relationship between the environment and company value.

Studies from Bodhanwala & Bodhanwala (2018), Buallay (2019), Safriani & Utomo (2020), and Triyani et al. (2020) concluded that social aspects influence the company's ROE and company value, while research Buallay (2019) and Alareeni & Hamdan (2020) produces negative relationship results on profitability and company value. Regarding corporate governance, research from Han et al. (2016) and López-Toro et al. (2021) shows that it positively and significantly influences profitability and company value. However, Alareeni and Hamdan (2020) and Buallay (2019) state that corporate governance has a positive effect on ROE, and according to Balasubramanian (2019), governance hurts company value.

ESG scores often measure environmental, social, and governance performance. In previous research, the ESG Score has influenced company profitability, and the ESG score is even said to be a reliable predictor for looking at company profitability (D'Amato et al., 2023). Then, Aydoğmuş et al. (2022) also found that ESG score performance significantly influences company profitability. Besides that, Melinda and Wardhani (2020) found that the ESG index significantly affected company value.

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In contrast to the opinion above, Dahlsjö & Hedström (2023) found no proven relationship between ESG Score and financial performance.

Based on the research above, there are still differences in research results regarding the influence of ESG on profitability and company value, which, therefore, still needs to be researched further. Apart from that, more research that uses ESG scores about profitability and company value in Indonesia still needs to be done. What differs from previous research is that this research will use the ESG Score from Bloomberg. Then, in this research, ESG will be used as a moderator variable for the influence of profitability on company value.

Concepts in legitimacy theory can help analyze the relationship between a company and its environment (Mousa & Hassan, 2015). Parsons (1960) defines Legitimacy as "an assessment of actions related to shared values in the context of action involvement related to the social community." Maurer (1971) states that Legitimacy is a process in which an organization or company is accountable for its rights in its business and operations, including maintaining sustainability and importing, changing, and exporting energy resources or information.

RBT theory views a company as a collection of tangible and intangible assets, resources, and capabilities (Firer & Mitchell Williams, 2003). The same thing was also expressed by Fahy & Smithee (1999), who stated that company resources that can provide competitive advantages for companies can be divided into three types, namely tangible, intangible, and human resource capabilities. According to research (Barney et al., 2021), Resource Based Theory (RBT) states that a company's intangible resources are more likely to contribute to the achievement and sustainability of superior company performance when combined or integrated.

The implementation of social and environmental responsibility has impacted company performance. The benefits received by the company can be seen from increasing reputation, innovation capabilities, consumer loyalty, and customer satisfaction, which ultimately impact company performance (D'Amato et al., 2023). D'Amato et al. (2023) found that ESG scores impact company profitability. This finding is also supported by research (Aydoğmuş et al., 2022), (Setiani, 2023), (Wu, 2023) and (Ma'in et al., 2022).

The fundamental theories used in developing hypotheses are legitimacy theory and resource-based theory. A company's Legitimacy can be threatened if management fails to disclose concrete actions to the public that convincingly demonstrate compliance with aspects of social responsibility (Newson & Deegan, 2002). Therefore, companies must implement and comply with societal and environmental regulations. Resources-based theory (RBT) is a theory that states that companies can gain a competitive advantage by utilizing environmental resources and company capabilities in the form of a knowledge/learning economy or relying on intangible assets (Kor & Mahoney, 2004).

Based on legitimacy theory and RBT, the company will gain Legitimacy from society, the company's reputation will grow, customer loyalty and satisfaction will grow, and this will impact the company's financial performance. In addition, with the existence of intellectual capital, it is hoped that companies will be able to increase their environmentally sound economic capabilities and increase resource use efficiency, improving the company's financial performance. From the above explanation, the hypothesis proposed is H1: ESG significantly influences company profitability.

Then, profitability is often linked to company value. Titman et al. (2018) stated that profitability is one of the factors that can increase company value. In calculating a company's fundamental value, the value of free cash flow will be measured by the company's operational performance, one of which is in the form of company profitability (Titman et al., 2018); (Dinarjito, 2022). Signaling theory can be used to develop further hypotheses. Company profitability can be a

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signal for investors regarding the company's prospects. The company's profit value can be a positive signal whose impact is increased share prices and vice versa (Titman et al., 2018).

Apart from profitability, company value is also influenced by the ESG Score. A high ESG score means that the company has good governance and has done work to protect the environment and society. This will have an impact on investor confidence and influence share value. (Plumlee et al., 2015) I have researched the relationship between sustainability reports and company value-using companies in America. The result is that sustainability disclosure has a significant influence on company value. Aboud & Diab (2018) and Yoon et al. (2018) examined the relationship between ESG disclosure and company value, which resulted in the ESG index significantly influencing company value.

From the explanation above, the hypothesis proposed is H2: Profitability significantly influences company value. H3: ESG has a significant influence on company value. H4: Profitability significantly influences company value, with ESG as a moderating variable.

METHODS

This research is deductive quantitative research. The objects used in this research are companies listed on the Indonesia Stock Exchange (BEI) from 2016 to 2021. The type of data used in this research is secondary data. Secondary data is data that refers to information collected from existing sources. The data used in this report are the financial reports of all companies listed on the IDX with ESG scores from 2016 to 2021. This data was taken from Bloomberg. Data will be analyzed using regression analysis.

This research uses samples selected using the purposive sampling method. Sugiyono (2016) calls purposive sampling a technique for selecting research samples using specific criteria to obtain more representative data. These criteria are as follows:

1. The company was registered on the IDX from 2016 to 2021.
2. The company has an ESG Score from 2016 to 2021.
3. The company has completed financial reports from 2016 to 2021.

The sample used in this research, based on data from Bloomberg, can be seen in Table 1.

Table 1. Samples Criteria

No	Sample Criteria	Total
1	Companies listed on the IDX that have an ESG score on Bloomberg 2016-2021	75
2	ESG score data is incomplete	-33
	Financial statement data is incomplete	0
3	Number of company samples	42
	Year of observation	5
	Number of observations	210

The dependent variable in this research consists of company value as measured by stock market value and profitability as measured by return on assets (ROA). According to (Titman et al., 2018), company value will describe shareholder wealth, which is more accurately measured by share market value. Profitability in this research uses ROA. (Brigham and Houston, 2018) state that ROA also shows better company performance because it can illustrate the efficiency and effectiveness of using company assets.

This research's independent and moderating variable is ESG, which the ESG Score represents. ESG Score is the three main factors for measuring sustainability performance carried out by

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companies and is helpful for investors in determining investment decisions (idx.co.id). The three main factors are Environmental, Social and Governance.

The control variables used in this research are leverage, company size, and liquidity. Company leverage is measured using the Debt Equity Ratio (DER), company size is measured using the natural logarithm of total assets, and liquidity uses the current ratio. In answering research questions, the author built three research models, namely:

a. Model 1: $ROA_{it} = a + b_1ESG_{it} + b_2LEV_{it} + b_3LNT_t + b_4CR_{it}$
b. Model 2: $MV_{it} = a + b_1LONG_{it} + b_2LEV_{it} + b_3LNT_{it} + b_4CR_{it}$
c. Model 3: $MV_{it} = a + b_1ESG_{it} + b_2LONG_{it} + b_3ESG*ROA_{it} + b_4LEV_{it} + b_5LNT_{it} + b_3CR_{it}$

Information:
MV: Company value as measured by the Logarithm of Natural Market Value
ROA: Company profitability is measured by Return on Assets (ROA)
ESG: Environment, Social, and Governance as measured by the ESG Score
LEV: Leverage measured by Debt-to-Equity Ratio (DER)
LNT: Total Assets as measured by the Natural Logarithm of Total Assets
CR: Liquidity as measured by the Current Ratio

RESULT AND DISCUSSION

Based on the results of data identification in Table 1, 42 companies met the data selection criteria. With a testing time of 6 years, the data used was 252. Based on Table 2, the companies' average market price of shares in the research sample is IDR 4,358. The highest share price was PT Gudang Garam Tbk. in 2017, and the lowest share price was PT Lippo Karawaci Tbk. in 2021, with a price of 141. Furthermore, the average return on assets (ROA) is 6.17, which means that the average rate of return on total assets in the sample company is 6.17. PT Matahri Department Store Tbk obtained the highest ROA value in 2016, with a value of 46.17. The lowest ROA value occurred at PT Sri Rejeki Isman Tbk. in 2021, with a value of -70.08.

Then, the average ESG score is 2.36. The company with the highest ESG score was PT Indo Tambangraya Megah Tbk. in 2020, with a value of 6.24, and the lowest ESG score was PT Ramayana Lestari Sentosa Tbk. in 2017, with an ESG value of 0.69. The higher the ESG score, the better the company can carry out its operations by prioritizing good management and environmental and social benefits.

Table 2. Descriptive Analysis of Variables

Variable	Observation	Mean	Std Dev	Min	Max
MV	252	4358,427	10019,91	141	83800
ROA	252	6,174157	9,082546	-70,0761	46,17435
ESG	252	2,361071	1,249664	0,69	6,24

After conducting descriptive analysis, the next step is to carry out a model selection test before the classical assumption test. The model selection test was carried out using the Chow, Hasuman, and Breusch-Pagan Lagrange Multiplier tests. Above the three models that will be analyzed, the results can be seen in Table 3. Based on Table 3, the fixed effect model for model 1 is the better model. Meanwhile, for models 2 and 3, the random effect model was chosen.

Table 3. Model Selection Test Results

Model	CEM	FEM	REM
Model 1		✓	

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Model 2	✓
Model 3	✓

After testing the model selection, the next step is to test the classical assumptions for all models. Model 1, the classical assumption tests tested are the multicollinearity test and heteroscedasticity test, considering that the selected model is FEM. Normality and autocorrelation tests do not need to be carried out, considering the nature of panel data with samples of more than 100 (Gujarati & Porter, 2009). In models 2 and 3, the classical assumption test used is the multicollinearity test. The results of the classical assumption test show that all models met the requirements, as shown in Table 4.

Table 4. Classic Assumption Test Results

Model	Breusch Pagan	VIF
Model 1		
Current Ratio	0,0844	1,38
LEV		1,23
LnTotalAset		1,19
ESG		1,06
Model 2	**Breusch Pagan**	**VIF**
ROA		2,06
LEV		3,3
LnTotalAset		9,0
Current Ratio		7,69
Model 3	**Breusch Pagan**	**VIF**
ROA*ESG		5,5
ROA*ESG		4,39
ESG		1,97
Current Ratio		1,42
LEV		1,27
LnTotalAset		1,25

Based on Table 5, the value for model 1 is 0.0856, meaning that the research variables can explain the variation in company profitability as measured by ROA by 8.56%. The remaining 91.44% is determined by other variables not included in the model.

Meanwhile, the value R^2 for model 2 is 0.2150, meaning that the variation in company value that the research variables can explain is 21.50%. The remaining 78.50% is determined by other variables not included in the model.

The value for model 3 is 0.2185, meaning that the variation in company value that the research variables can explain is 21.85%. The remaining 78.15% is determined by other variables not included in the model.

The research coefficient of determination value of 8.56% for model 1, 21.50% for model 2, and model 3 21.85% is relatively low; however, Ghozali & Ratmono (2017) explain that the purpose of regression analysis is not solely to obtain values the highest. When the value is low, it does not mean that the regression model in the research is a regression model that is not suitable for use.

Table 5. Data Analysis Results

Variable	Model 1	Model 2	Model 3

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	Coefficient	Probability	Coefficient	Probability	Coefficient	Probability
ESG		0,1286			-1,275533	0,559
LEV		0,2124	-0,0009318	0,0020	-0,007363	0,003
LNTotalAsset	-0,007272	0,6056	0,2241915	0,0000	0,225576	0,001
Current Ratio	2,489241	0,0011	-0,0291489	0,4230	-0,0295376	0,426
ROA			0,0230226	0,0000	0,0185532	0,007
ROA* ESG					0,0021982	0,464
Rquare	0,0856		0,215		0,2185	
F-Sig	0,0010		0,0000		0,0000	

In Table 5, the F probability value for model 1 is 0.0010, and for model 2 and model 3, it is 0.0000. This result is smaller than the significance level $\alpha = 0.05$ so that the simulant that can be taken is this research model, both for model 2 and model 3, all variables in this research model simultaneously have a significant effect on the dependent variable, namely company value, as well as for Model 1: All variables in the research model simultaneously have a significant effect on company profitability.

The answer to the hypothesis can also be seen in Table 4. Based on the test results above, it is concluded that ESG does not affect company profitability. These results are not by the RBT theory. RBT theory states that all assets can provide a competitive advantage, resulting in sustainable company performance. Companies that have managed their companies by sustainability principles will have intangible assets that can increase stakeholder trust. Clark et al. (2014) state that companies that have implemented ESG will produce better operational performance. Cakranegara and Sidjabat (2021) stated that companies implementing ESG will increase the company's competitive advantage, which will ultimately increase company value. Implementing ESG by existing regulations will increase the company's credibility. Revenue growth depends on improving the company's image and customer trust, which influences the acquisition of loyalty to the company Safriani & Utomo (2020), D'Amato et al. (2023).

The results of this research are in contrast to research from Buallay (2019), López-Toro et al. (2021), D'Amato et al. (2023), and Aydoğmuş et al. (2022), who say that ESG influences profitability. However, this research agrees with research from Alareeni & Hamdan (2020), Atan et al. (2018), and Dahlsjö & Hedström (2023) say the opposite result. One of the reasons for this difference is that the costs of running ESG do not provide optimal returns. There is a possibility that with the implementation of ESG in the company, the costs incurred have not yet reached the break-even point. This opinion is in Komaidi's opinion in Husaini (2022), which states that ESG will be an additional burden *(additional cost).*

Then, related to the second hypothesis, the research results show that profitability significantly affects company value. The variable coefficient is positive, meaning the higher the profitability, the greater the company value. These results are based on financial principles and signal theory, which states that good information, in this case, profitability, will be reflected in stock prices (Titman et al., 2018).

The results of this research are in line with Harahap et al. (2020), Liow (2010), and Salvi et al. (2021), which state that there is a significant and positive influence of company profitability on company value. When a company can manage its assets well to generate income, it automatically generates profits. Company profits will signal investors to buy their shares so that share prices will rise. In addition, the profits generated by the company will directly impact additional company equity, which will, in turn, increase the value of shareholder equity. This will also have a positive impact on the company's market value.

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The results of this study are not in line with the research of Bhimantara and Dinarjito (2021), which state that profitability does not affect company value. Apart from that, this research is also different from the research of Leman et al. (2020), which shows that profitability hurts company value.

The results of the third hypothesis test show that ESG does not affect company value. The results of this study are not in line with research Plumlee et al. (2015), Aboud & Diab (2018), Yoon et al. (2018), Melinda & Wardhani (2020), Buallay (2019), Li et al. (2018), Alareeni & Hamdan (2020), López-Toro et al. (2021) who found that ESG has a significant effect on company value. The results of this research are also not in line with the research by Balasubramanian (2019), which also shows a negative relationship between the environment and company value.

The results of this study are not based on research Sebti (2019), Bhimantara & Dinarjito (2021), signal theory, and RBT. In signal theory, it is stated that if a company has carried out good performance management, one of which is reflected in its ESG score, then its performance should improve because it will have a competitive advantage. However, with the results of this research, it is possible that the company still needs to implement good ESG fully and, therefore, has not been able to provide confidence to investors. Clark et al. (2014) stated that investors are now looking at non-financial information in making investment decisions. The results of this research are not by the hypothesis. It is also possible that investors need to understand the need to be in the ESG score or that the ESG score value is unrelated to the numbers in the financial statements.

According to legitimacy theory, a company will gain public trust if it can care about the environment by maintaining its sustainability. If hypothesis 3 is not proven, it is possible that the company has not implemented ESG values thoroughly.

In the fourth hypothesis, the test results show that ESG cannot moderate the relationship between company profitability and value. These results are in line with research from Bhimantara and Dinarjito (2021), Sebti (2019), and Khairina (2018). This difference in results is likely because ESG information has not been able to influence investors in making investment decisions (Sebti, 2019).

The difference in results is also likely due to the need for harmony between the strategies contained in ESG and the company's goal of increasing company value and profits. This also causes investors to think that there is a possibility that ESG is only an effort by companies to fulfill company obligations by existing regulations.

CONCLUSION

Based on the data analysis and testing results, several conclusions can be drawn that ESG has no effect on company profitability. It is possible that the costs used to fulfill ESG values may not profit the company, thereby increasing its costs. The company's strategy and goals have not implemented ESG, so it has not provided benefits for the company. The second conclusion is that ESG has not been able to influence company value significantly. This is possibly caused by the company's ineffective ESG strategy, which can be seen from the ESG score, which is still much below average. This means that investors have not used ESG information to make investment decisions. The third conclusion is that profitability significantly and positively affects company value. The higher the profitability, the higher the company value. This is by signal theory and financial principles, where good information will be reflected in an increase in the company's share price. The conclusion is that ESG has not been able to moderate the relationship between profitability and company value. As explained above, by looking at a low ESG score, it is possible that the company has not implemented ESG values by its objectives, and investors have not seen ESG as necessary in making investment decisions.

Advice can be given to companies in making company plans to accommodate ESG values so that companies can achieve sustainability goals. A high ESG score will show that the company also focuses on sustainability issues. Suggestions for further research are to add other variables, such as dividend policy, and increase the research period.

The limitation experienced in this writing is that the data has yet to be updated because ESG score data for 2022 still needed to be created at the time the research was carried out. Therefore, this research only uses data up to 2022.

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