
The Influence of Environment, Social, Governance (ESG) Disclosure and Company Characteristics on Profitability

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Abstract

This study aims to determine the effect of Environmental, Social, and Governance (ESG) disclosure and company characteristics on profitability. The study was conducted on mining companies listed on the Indonesia Stock Exchange from 2021 - 2023. The sample was selected using purposive sampling. A sample of 120 data companies was obtained. The data was processed using multiple regression. The study concluded that ESG disclosure and company size have a positive effect on profitability, while company age has no effect on profitability. Based on the research findings showing that ESG Disclosure has an effect on profitability, this study has implications for companies, which should not only focus on financial performance. Companies should also strengthen corporate governance and integrate sustainability principles into their business strategies to continuously improve ESG quality.

Keywords: ESG disclosure, company characteristics, profitability

1. Introduction

1.1. Background

In carrying out their business activities, companies are not only responsible to stakeholders but also to their social environment (Said et al., 2009). Environmental, Social, and Governance (ESG) disclosure should also be considered when making decisions. ESG disclosure is an indicator of a company's performance in environmental awareness and corporate governance. Environmental, Social, and Governance (ESG) aspects have become a focus of attention in the business world in recent years. In addition to serving as a framework for sustainability and ethical practices, ESG considerations also have a significant impact on a company's profitability (Hendra Lesmana, 2023).

Environmental, Social, and Governance Disclosure (ESG Disclosure) is the latest form of social and environmental reporting. It began with voluntary disclosures regarding social responsibility in the form of Corporate Social Responsibility (CSR) disclosures, followed by Sustainability Reporting and integrated reporting (Faisal et al., 2018). ESG disclosure takes the form of disclosures related to environmental, social, and governance. ESG Disclosure is a communication tool for companies with stakeholders regarding the environmental, social, and

governance activities implemented by the company. The level of ESG disclosure can be seen from the ESG Score (Li et al. (2018). Currently, ESG disclosure is very important for companies to do. For investors, the ESG score can be used to evaluate a company's sustainability performance (Zuraida, Hogue and Zijl, 2016). In Indonesia, investors can obtain ESG disclosure information in the Sustainability Report. According to the Director of Finance and Human Resources of the Indonesia Stock Exchange, companies that report on Sustainability are increasing. As of December 30, 2021, there were 154 companies that had reported on sustainability. This is an increase compared to 2019, which was only 54 companies (Majalah CSR, 2022).

Previous research on the influence of ESG disclosure has been conducted, but the results are inconsistent. Research by Leony et al. (2024) concluded that ESG disclosure impacts profitability. Pangentas & Prasetyo (2023) stated that Environmental Disclosure has a positive effect on Return on Assets. Meanwhile, Social Disclosure has a negative effect on Return on Assets. Governance Disclosure negatively impacts Return on Assets. Other researchers, Ghazali & Zulmaita (2020), stated that environmental disclosure, social disclosure, and governance disclosure have no effect on company profitability. However, ESG disclosure simultaneously impacts company profitability.

Research on the influence of company size on profitability also yields mixed results. Research by Isik & Unal (2017) and Juliana and Melisa (2019) showed that company size significantly impacts profitability. Meanwhile, research by Nurdiana (2018), Sukmayanti & Nyoman (2019) showed different research results, namely, company size had no effect on profitability.

Company age has a positive relationship with profitability. Long-established companies generally have higher profitability than newly established companies. This is because newly established companies require significant investment funds, so the percentage of funds allocated to business development to increase profitability is limited. According to Noveliza (2022) and Rusmawati (2022), company age has a significant effect on company profitability.

This study replicates the research by Leony et al. (2024). The differences between this study and previous studies include: 1). The addition of research variables in the form of company characteristics. The company characteristics variable is proxied by company size and company age. This variable was added because company characteristics, which are proxied by company size, have an impact on profitability (Kinesti, 2020). The company age variable was added because company age influences profitability (Rusmawati, 2022). 2). The previous profitability measurement, ROA, was replaced with EPS. This replacement is because by looking at EPS, investors can determine a company's prospects. 3). The population was replaced with mining companies listed on the IDX between 2021 and 2023. Mining companies were chosen because they have a significant impact on the environment (Listiyani, 2017).

1.2. Literature Review

1.2.1. Stakeholder Theory

Stakeholders are all parties, both internal and external, who influence or are influenced by a company, directly or indirectly (Hadi, 2011). A company's success can be determined by its management's ability to foster relationships between the company and its stakeholders. Activities related to Environmental, Social, and Governance (ESG) can impact a company's survival and will garner support from stakeholders. Environmental, Social, and Governance (ESG) disclosures describe information related to a company's governance, social, and environmental responsibilities to stakeholders.

1.2.2 Legitimacy Theory

Legitimacy is a crucial factor influencing companies' adherence to social boundaries, ensuring they comply with prevailing rules, values, and norms in society (Dowling and Pfeffer, 1975). Legitimacy theory focuses on the relationship between organizations and their social environment. Legitimacy theory explains that organizations conduct their business activities within social boundaries and norms (Deegan, 2016). Legitimacy limits a company's actions to social values, thus requiring companies to disclose corporate social responsibility to demonstrate their social compliance to society.

1.2.3. Agency Theory

Agency theory explains the relationship between a principal and an agent, where the principal is the authorized party who issues orders to the agent to carry out tasks on behalf of the principal (Jensen and Meckling, 1976). Within a company, there is a different of interests between the principal (investor) and the agent (manager). Investors authorize managers to make decisions that benefit the company, while managers delegate the authority to manage company resources. Managers will make various efforts to ensure their performance is perceived favorably (Kumalasari and Puspaningsih, 2024). This can happen especially when the person involved in the process is an opportunist and is strongly driven by personal interests (Jusoh et al, 2022).

1.2.4. ESG Disclosure

ESG disclosure considers an organization's environmental, social, and governance factors. According to Baier et al. (2018), social and environmental responsibility towards society is assessed through an ESG score. Corporate social responsibility and sustainable business are based on ESG components, which include environmental, social, and governance. The implementation of ESG in Indonesia is regulated by the Financial Services Authority through OJK Regulation No. 51/POJK.03/2017. This regulation regulates "The Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Government Companies."

1.2.5. Profitability

Profitability is a key measure of financial performance. Profitability focuses on an organization's ability to generate profits from its activities or investments (Rataj et al., 2024). At the beginning of a change, sustainability values are often prioritized because they are seen as driving innovation and change. As the change progresses, financial returns also become more important.

1.3. Hypothesis Development

The larger a company, the more activities it engages in. Publicly listed companies have more owners (investors). Investors require information from the company, including ESG disclosures. ESG disclosures by companies make it easier for stakeholders to access information regarding the company's commitment to Environmental, Social, and Governance (ESG). This explanation suggests that ESG disclosures increase as companies grow. This is supported by research by Vivianita and Roestananto (2022). More ESG disclosures indicate that the company's activities are more environmentally friendly, with higher employee productivity and retention, risk mitigation, and sound corporate governance. These activities are expected to increase customer loyalty and growth, leading to increased sales. This is expected to increase profitability. Based on the above explanation, the hypothesis is:

H1: ESG disclosure has a positive effect on profitability.

Company size influences profitability. The greater a company's assets, the more funds it has available to develop strategies and innovate to increase sales. Increased sales naturally increase profitability. Research by Isik & Unal (2017) and Juliana & Melisa (2019) shows that company size significantly influences profitability. Based on the above description, the following hypothesis is proposed:

H2: Company size has a positive effect on company profitability.

Company age has a positive relationship with profitability. Long-established companies generally have higher profitability than newly established companies. This is because newly established companies require significant capital for investment, so the percentage of funds allocated for business development to increase profitability is limited. According to Noveliza (2022) and Rusmawati (2022), company age has a significant effect on company profitability. Based on the above description, the following hypothesis is proposed:

H3: Company age has a positive effect on company profitability.

From the hypothesis above, the research model is as follows:

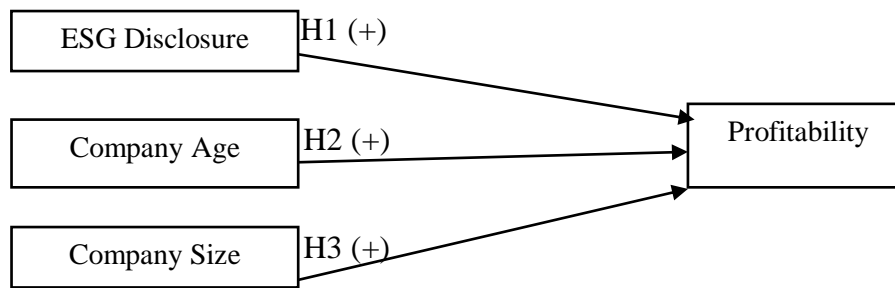


Figure 1: Research Model

2. Research Method

2.1. Population and Sample

The population in this study was mining companies listed on the IDX between 2021 and 2023. The sample was selected using purposive sampling. The sample selection criteria were as follows:

- a. Listed consecutively during the 2021-2023.
- b. Have ESG disclosure data and other data required for this research.

2.2. Measurement Variable

The dependent variable in this study is profitability. Profitability is measured using Earnings per Share (EPS). The independent variables in this study are:

- a. ESG Disclosure.

Data was obtained from Sustainability Reports or annual reports of mining companies listed on the Indonesia Stock Exchange (IDX) for the 2021-2023. ESG disclosure in this study was measured using ESG indicators contained in the appendix to OJK Regulation No. 51/POJK 03/2017. ESG disclosure is the number of ESG items disclosed by a company divided by the total number of ESG items.

$$ESGD_i = \frac{\sum X_i}{n}$$

Information:

ESGD_i: company ESG disclosure i

X_i : The number of items disclosed by the company, if disclosed the value is 1 and if not disclosed the value is 0

n : Number of ESG disclosure item indicators

- b. Company size. This variable is measured using Ln Total Assets.
- c. Company age. This variable is calculated from the year the company was founded until year of research.

3. Results and Discussion

3.1. Research Object

The population in this study is mining companies listed on the Indonesia Stock Exchange (IDX) between 2021 and 2023. The sample was selected using purposive sampling. The following is the sample for this study:

Table 1 Research Samples

No	Criteria	Amount
1	Mining companies listed consecutively on the IDX in 2021 – 2023	42
2	Mining companies that do not include complete information to support research	(2)
	Number of sample companies	40
	Observation year (2021-2023)	3
	Number of sample companies during the observation year	120

3.2. Descriptive Statistics

The following are the results of the descriptive statistical analysis:

Table 2. Descriptive Statistical Analysis

	n	Minimum	Maximum	Mean	Std. Deviation
Profitability	120	-1122.22	7979.62	394.8155	985.52273
ESG Disclosure	120	0.32	1.00	0.6573	0.22521
Company Siza	120	13.00	28.62	18.9123	4.59545
Company Age	120	14.00	56.00	32.3250	12.20013
Valid N (listwise)	120				

3.3. F Test

The following are the results of the F test:

Table 3. The Results of F Test

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	38549037.426	3	12849679.142	19.350	0.000 ^b
	Residual	77030312.955	116	664054.422		
	Total	115579350.380	119			

a. Dependent Variable: Profitability

b. Predictors: (Constant), Company Size, Company Age, ESG Disclosure

From the table above, it is known that the probability value (sig) of 0.000 is much smaller than 0.05, so it can be concluded that the model used is suitable for use in this research.

3.4. Regression Coefficient Test

Table 4 Regression Coefficient Results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.578 ^a	0.334	0.316	814.89534

a. Predictors: (Constant), Company Size, Company Age, ESG Disclosure

The table above shows that the Adjusted R² (Determinant Coefficient) value is 0.316, or 31.60%. This means that 31.60% of the Profitability (dependent) variable can be explained by the independent variables in the study, while the remaining 68.40% is explained by other variables not tested in this study.

3.5. Results of this Regression Test.

The following are the results of the regression tests that have been carried out :

Table 5. Results of this Regression Test

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	-1661.300	373.674		-4.446	0.000
	ESG Disclosure	1415.421	412.930	0.323	3.428	0.001
	Company Size	68.607	20.236	0.320	3.390	0.001
	Company Age	-5.311	6.124	-0.066	-0.867	0.388

a. Dependent Variable: Profitability

The analysis yielded the following results:

- The ESG Disclosure variable had a t-value of 3.428 and a probability of 0.001, indicating significance.
- The company size variable had a t-value of 3.390 and a probability of 0.001, indicating significance.
- The company age variable had a t-value of -0.867 and a probability of 0.388, indicating insignificant.

From the table above, the regression equation is as follows:

$$Y = -1661.300 + 1415.421 \text{ ESGDisc} + 68.607 \text{ CompSize} - 5.311 \text{ CompAge} + e$$

3.6. Discussion

3.6.1. The Effect of ESG Disclosure on Profitability

The regression test results shown in Table 5 are significant. This indicates that Hypothesis 1 is supported. Therefore, it can be concluded that ESG Disclosure has a positive effect on profitability. This result suggests that greater ESG disclosure leads to higher profitability. Larger companies typically have more and more competent employees, thus increasing their capacity for ESG disclosure. A greater number of ESG items disclosed creates a positive impression among stakeholders. This positive impression also impacts sales, thus driving increased profitability.

These test results align with research by Leony et al. (2024), which concluded that ESG disclosure affects profitability. Other researchers, Ghazali & Zulmaita (2020), stated that ESG disclosure simultaneously affects a company's profitability. On the other hand, these results differ from research by Pangentas & Prasetyo (2023), which found that social disclosure negatively impacts profitability.

3.6.2. The Effect of Company Size on Profitability

The regression test results shown in Table 5 are significant. This indicates that Hypothesis 2 is supported. Therefore, it can be concluded that Company Size has a positive effect on Profitability. From these results, it can be concluded that the larger the company (the greater the company's assets), the higher the profitability. Larger companies typically have more and more competent employees. Therefore, companies with employees with greater skills and higher competencies will be able to generate higher sales. High sales ultimately increase profitability.

These test results align with research by Isik & Unal (2017) and Juliana & Melisa (2019), which showed that company size significantly influences profitability. However, research by Nurdiana (2018) and Sukmayanti & Nyoman (2019) showed different results, namely, that company size had no effect on profitability.

3.6.3. The Effect of Company Age on Profitability

The test results shown in Table 5 indicate that the results are insignificant. This indicates that Hypothesis 3 is not supported. Therefore, it can be concluded that company age has no effect on profitability. This is likely due to the lack of attention ESG disclosures received by stakeholders, particularly those involved in sales. ESG disclosures, which exist due to OJK regulations, have not yet positively impacted sales. These test results not align with research by Noveliza (2022) and Rusmawati (2016), which found that company age significantly influences company profitability.

4. Conclusion

From the testing conducted, it can be concluded that:

- 1) ESG Disclosure and Company Size have a positive effect on profitability.
- 2) Company Age has no effect on profitability.

The results of this study show an Adjusted R² of 31.6%. Therefore, it is recommended that further research include other independent variables not yet used in this study. Future research can utilize other ESG measurement sources, such as Refinitive Eikon, Bloomberg ESG, and others, to increase the validity of the research results.

Based on the research findings showing that ESG Disclosure has an effect on profitability, this study has implications for companies, which should not only focus on financial performance. Companies should also strengthen corporate governance and integrate sustainability principles into their business strategies to continuously improve ESG quality.

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