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Exploring ESG, DER, and Firm Size Roles in Driving Financial Performance

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Abstract

Improving the achievement of financial result is one of the corporate's focuses every year. With a company having good financial performance, it could pull investors to invest some funds in the corporate. This basis attracts researchers to see what factors can influence the corporate's achievement in finance. For the current study, researchers observed factors of ESG, DER, and Firm Size which were used as independent research variables with the dependent variable being financial performance as proxy by ROA, so that the research objective was to conduct an analysis of the impact of independent variables on dependent variable. Purposive sampling, which is a type of non-probability sampling technique, was used in sampling this study, so that there were 14 companies listed on the IDX 80 used as samples in this study. The data analysis used is panel regression and uses a fixed effects model with a significance level of 5%. The test results show a negative influence of ESG, DER on ROA and positive influence on ROA is obtained by the Firm Size. This research imply that companies need to strategically integrate ESG to support long-term profitability and balance debt management.

Keywords: DER, ESG, Financial Performance, Firm Size, ROA.

INTRODUCTION

The results of a company's financial achievements are an important measure of a company's success and sustainability and are a primary focus for investors, managers

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and policy makers. Financial performance reflects the corporate's ability to generate profits and consistently maintain growth. Financial performance is often measured by ROA (Return on Assets), which indicates how effectively a corporate manages its assets to achieve profits. A high ROA indicates maximum asset utilization, the company is well managed and has the potential to generate profits.

Companies need to pay attention to their financial performance to maintain investor confidence and market stability, especially companies listed on the Indonesia Stock Exchange (IDX), which are among the 80 most liquid and large-cap stocks on the IDX, representing leading companies across various industries. These companies are expected to consistently deliver superior financial performance. Therefore, it is important to delve into the factors that impact the financial achievements of IDX80 companies.

One of the factors that needs to be considered in creating good financial achievements is ESG (Environmental, Social, and Governance). This ESG factors is an important thing to consider because there has been quite rapid development in both academic research and practice, where in recent years companies are required to pay attention to long-term value creation related to their business policies, including ESG.

Environment is the first factor in ESG which focuses on the impact of a company's business operations on the environment, climate change, the company's role and efforts in protecting the natural environment. Social factors describe the company's relationship with external parties by providing company contribution to the community, suppliers, and buyers, paying attention to human rights, and equality in the workplace. Governance relates to the fair treatment of minority shareholders and transparency in information disclosure (Atan et al., 2018).

The implementation and disclosure of ESG is one way to companies to promote their business due to the increasing awareness of stakeholders so that companies can use sustainable resources so that with limited resources, their existence can still be used for future generations. By companies making ESG disclosures, they can improve the company's reputation and create competitive advantage (Brown et al., 2010). ESG disclosures will benefit companies and stakeholders as actions that lead to superior decision making, transparency efforts, contribute to better social sustainability, and increase financial stability (Eccles & Saltzman, 2011). This explanation aligns with the findings of research conducted by Alareeni & Hamdan (2020), Almeyda & Darmansyah (2019), De Lucia et al. (2020), Naeem et al. (2021), and Nugroho & Hersugondo (2022) which found that ESG implementation positively impacts corporate financial performance, potentially helping companies achieve long-term financial sustainability and contrary to

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the research results from Buallay (2019), Duque-Grisales & Aguilera-Caracuel (2021), and Ruan & Liu (2021) which show that ESG implementation negatively impacts financial performance due to additional costs from investing in ESG implementation which in the short term can negatively impact company revenue.

The second factor focused on in this study is the total debt-to-equity ratio, abbreviated as DER. DER is defined as a ratio used by companies to assess their financial leverage by comparing total debt to equity and to determine the extent to which a company relies on debt funding compared to equity funding in funding its operational activities. A high DER value indicates that the company has grater debt, which can increase financial risk but can also generate higher profits. Conversely, a low DER value may indicate a more conservative financing approach with greater reliance on equity. According to Putri & Kusumawati (2020), companies with high DER can experience increased financial pressure due to high interest payment obligations, which can negatively impact profitability. Another impact of the use of debt by companies is that effective debt management can provide opportunities for companies to have funds for expansion and can improve operational efficiency so that increasing debt can have the effect of increasing corporate profits. This statement is in accordance with the research results produced by Firmansyah & Armaniah (2024) and Kurniawati & Waluyo (2024) which inform that DER has a positive impact on company profits as measured by ROA.

The third factor, which is the last factor used in this study regarding company financial performance is company size. Larger companies gain benefits related to more diversified revenue streams, economies of scale, and greater market power that can positively impact financial performance. Furthermore, larger companies have resources available to invest in technology, innovation, and human resource development, thereby improving operational efficiency and increasing profitability. This is in line with research results from Oktavia & Titiek (2022) and Susanto (2022) which found a positive influence of company size on financial performance. However, in highly competitive industries, large company size causes higher operational complexity so that company size does not affect financial performance. The results of research conducted by Cahyana & Suhendah (2020) and Innaya et al. (2022) which shows that there is no influence of company size on the company's financial performance in accordance with the statement above.

From the explanation that has been presented, this study aims to examine the determinants of financial performance as measured by ROA, namely ESG, DER, and company size in large-capitalization companies included in the IDX 80. The study results

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are expected to contribute to the existing literature by offering new insights into the role of sustainability and company characteristics in shaping company financial performance.

LITERATURE AND RESEARCH HYPOTHESIS DEVELOPMENT

ESG is currently becoming increasingly important in assessing overall corporate performance due to investors' perceptions that companies implementing ESG are more responsible and better at managing risks related to environmental, social, and governance issues. ESG implementation is also a sustainable practice that can increase stakeholder trust, reduce operational risk, and potentially improve financial performance. Several empirical studies have shown that corporates with high ESG values tend to have better financial performance due to a good reputation and reduced costs associated with environmental and social responsibility.

This align with the finding of studies by Alareeni & Hamdan (2020), Almeyda & Darmansyah (2019), De Lucia et al. (2020), Naeem et al. (2021), and Nugroho & Hersugondo (2022), which found a positive impact of ESG on financial performance. Companies that prioritize ESG implementation contribute to sustainable operation, increasing profitability, and asset efficiency. Therefore, research hypothesis one:

H_1: ESG has positive impact on financial performance.

DER measures corporate's financial leverage and it is an important indicator in assessing a corporate's financial health. A high DER indicates a corporate's heavy reliance on debt to finance its operations. A high DER can increase financial risk due to the burden of debt payments and interest obligations, which can affect the corporate's financial performance. The results of research conducted by Putri & Kusumawati (2020), Situmorang (2023), and Tasmil et al. (2019) are in line with the statement above where DER has negative impact on corporate's financial performance. Therefore, research hypothesis two:

H_2: DER has negative impact on financial performance.

Larger corporate can benefit from economics of scale, easier access to capital, and greater market power. These advantages enable larger companies to operate more efficiently, reduce costs, and increase profitability, resulting in strong financial performance. Additionally, larger companies are generally more diversified, helping them mitigate risk, and maintain stable performance across the business cycle.

This statement is in line with the research results obtained by researchers Oktavia & Titiek (2022) and Susanto, (2022) who stated a positive influence of company size on financial performance. Thus research hypothesis three:

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H_3: Firm size has positive impact on financial performance.

Based on the development of the research hypothesis above, the research model can be seen in Figure.

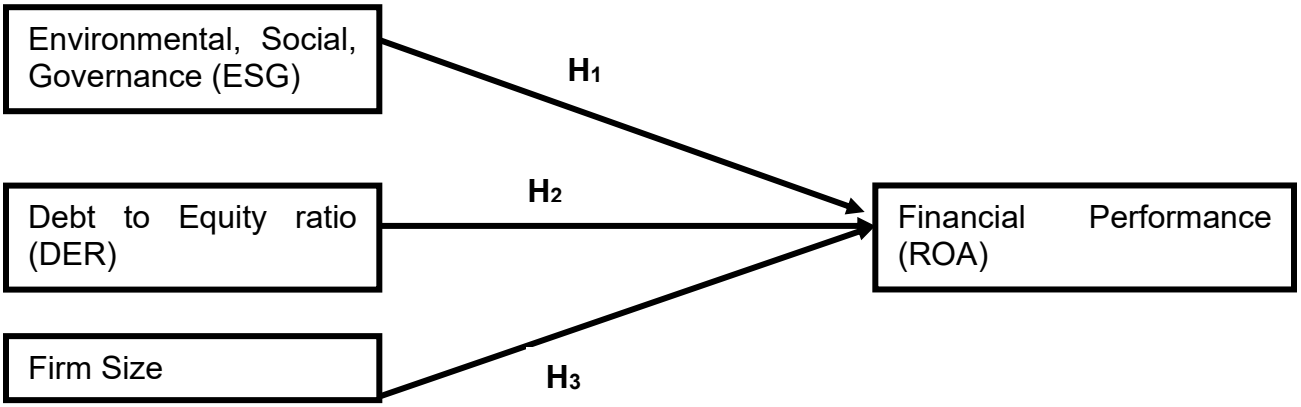


Figure 1 Research Model

RESEARCH METHODOLOGY

Quantitative research with a type of research based on research objectives, namely causal research, is used in this research. The research population was all companies included in the IDX 80 from 2017-2023. Purposive sampling was used as the sampling technique for this study, with the following criteria: (1) corporates consistently listed on the IDX 80 from 2017-2023; (2) companies that have complete financial reports from 2017-2023; (3) corporates that have complete ESG data obtained from Refinitiv; and (4) companies that are not include in the financial sector. Based on these criteria, 14 companies listed on the IDX 80 were obtained which were used as research samples.

ESG, DER, and firm size, which are all independent variables, are used in this study, with the dependent variable being the corporate's financial performance proxied by ROA. The measurements used in this research variables can be seen in table 1. For this research, the researcher used panel data by collecting data using archival data, namely databases. The research data obtained were processed and analyzed using the panel data linier regression method with EViews software.

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Table 1. Operational definition of Variables

No	Research Variable	Formula	Measurement Scale
1	ESG (X1)	ESG scores are obtained from the Sustainability Leadership Monitor on Refinitiv	Ratio
	DER (X2)	DER = Total debt / Total equity	Ratio
	Firm size (X3)	Firm size = Ln (Total assets)	Ratio
2	Financial Performance (Y)	ROA = NIAT / Total assets	Ratio

Source: Researcher Observation Results

RESULTS and DISCUSSION

The first step in processing the collected research data is to conduct a model test to determine which model can be used to test the research hypothesis. The Chow test was conducted first, where the results of the Chow test can be seen in table 2. The test results inform that the probability value of the cross-section F is 0.000 < 0.05, which means that the appropriate model to use in testing the research hypothesis is the fixed effect model (FEM).

Table 2. Result from Chow Test

Effect Test	Statistic	Degree of freedom	Probability Value
Cross-section F	26.864035	(13.81)	0.0000
Cross-section χ^2	163.647897	13	0.0000

Source: EViews result

The researcher conducted a second test, namely the Hausman test, where the Hausman test was conducted to compare the fixed effects model (FEM) and the random effects model (REM). The results of the Hausman test can be seen in table 3 where the Hausman test yielded a χ^2 value with a probability value of 0.0031 < 0.05 which means that in this study the fixed effects model (FEM) is more suitable for use as a tool for testing research hypothesis compare to the random effects model (REM).

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Table 3. Result from Hausman Test

Test Summary	χ^2 Statistic	χ^2 Degree of freedom	Probability Value
Cross-section random	13.850961	3	0.0031

Source: EViews result

The second step taken by the researcher is to use the model to test the research hypothesis, the results of which can be seen in table 4.

Table 4. Results of Research Hypothesis Test

	Coefficient	Results	Decisions
ESG Score → ROA	-0.001479	Sig (2-tailed) = 0.0153	H1 Accepted
DER → ROA	-0.019177	Sig (2-tailed) = 0.0354	H2 Accepted
Firm size → ROA	0.086466	Sig (2-tailed) = 0.0032	H3 Accepted

Source: EViews result

DISCUSSION

The first research hypothesis is accepted, this shows that ESG has a negative impact on ROA and has a statistically significant impact with a coefficient of negative 0.001479 with a p-value of 0.0153 < 0.05 (Table 4). The negative impact of ESG on financial performance indicates that higher ESG related costs or investment in socially responsible practice do not directly benefit profitability, at least in the short term. In addition, negative impacts arise because the ESG variable focuses on long-term business sustainability, while the ROA variables is a measure of the corporate's short-term financial performance. Research results produced by Buallay (2019), Duque-Grisales & Aguilera-Caracuel (2021), and Ruan & Liu (2021) support the results of this study.

This condition show that the companies used as samples have implemented ESG, but ESG has a negative impact on ROA. This suggests that these companies have invested funds to implement ESG, a current requirement for business sustainability, but in the short term, this has not yielded any financial benefits in improving their financial performance. Investments in ESG implementation require time to yield short-term benefits for the sample companies.

The second research hypothesis was accepted, indicating that the DER variable influences the corporate's financial performance. Similar to the ESG variable, DER

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variable also has a negative impact on ROA and has a statistically significant impact with a coefficient of negative 0.019177 with a p-value of 0.0354 < 0.05 (Table 4). This study found that high debt can be associated with decreased ROA. This finding suggests that as financial leverage increases, profitability tends to decline due to higher interest payments and greater financial risk. This finding aligns with the results of studies conduct by Putri & Kusumawati (2020), Situmorang (2023), and Tasmil et al. (2019).

The corporates used as samples in this study have high debt so that they are risk of experiencing increased interest expenses and potential liquidity problems that can affect the company's profitability. Therefore, these companies need to be careful in managing their capital structure to avoid financial problems that could impact the corporate's financial performance.

The third research hypothesis is accepted, meaning that firm size variable influences the corporate's financial performance. Firm size has a positive impact on ROA and has statistically significant impact with a coefficient of positive 0.086466 with a p-value of 0.0032 < 0.05 (Table 4). These results indicate that the larger of firm size, the higher the corporate's ROA and consistent with the results of studies conducted by Oktavia & Titiek (2022) and Susanto (2022), which showed that firm size has a positive effect on a corporate's financial performance.

This positive effect of firm size on financial performance confirms that the companies sampled in this study are large. Therefore, these companies have easier access to financial institutions, greater access to resources, stronger market power, and more diversified revenue sources. The positive and significant influence of firm size on company financial performance strengthens the importance of firm size in supporting the company's financial performance.

CONCLUSION and RECOMMENDATION

Based on the research results and discussion, it can be concluded that ESG, DER, and firm size variables influence company financial performance. ESG and DER variables negatively influence financial performance, while firm size positively influences financial performance for companies listed on the IDX 80.

Overall, this research shows that although large corporates have an advantage on profitability, companies need to carefully manage their debt levels and strategically implement ESG initiatives to attain long-term financial performance. These findings provide valuable insights for company managers and policy makers in optimizing financial strategies and driving sustainable growth.

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Further research is recommended to use EVA to assess the corporate's financial performance because EVA is one of the measures of long-term financial performance that ESG is expected to impact on EVA, using multiple imputation methods to address missing data, increasing sample size, and extending the observation period.

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