

# The Effect of Esg Disclosure, Company Size, and Leverage On Company's Financial Performance in Indonesia

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**Abstract:** This study aims to examine the effect of disclosure of ESG, Company Size, and Leverage on Company Financial Performance. The population in this study are all companies listed on the Indonesia Stock Exchange (IDX) in 2018-2021. The sample was selected using a purposive sampling technique, in order to obtain 42 samples of companies that met the criteria with 168 data used as research samples. Financial Performance is proxied by Return on Assets and Tobin's Q, The results showed that Leverage only had an effect on financial performance which was proxied by Return on Assets, and disclosure of ESG, Firm size, Leverage had an effect on financial performance which was proxied by Tobin's Q.

**Keywords:** ESG, Financial performance, Leverage, Tobin's Q, Company Size

## I. INTRODUCTION

ESG disclosures provide an overview of the company's role in reducing negative impacts on the environment, the company's role in managing relationships with surrounding conditions, and how companies implement good governance policies [1]. Environmental, social, and governance refers to non-financial information about how a company deals with issues concerning these problems, and its importance for the assessment of company growth [2]. Although ESG information may not be standardized, experts argue that it can help adapt to changing environments and even become part of a company's competitive strategy [3].

With the increasing ease of access and information technology, ESG refers to three central factors measuring the impact of sustainability and ethics in making decisions to invest in certain businesses or companies [4]. These three factors are environmental, social and corporate governance. Investors generally use the criteria for the three factors above in their considerations to choose and sort out which investments they will take. [5]. Environmental, social and governance (ESG) disclosures have a long history in the corporate social responsibility (CSR) literature. ESG disclosures refer to corporate reporting that focuses on environmental, social, and governance performance [6] and are associated with a lower cost of equity capital. Companies that disclose ESG are able to increase the amount of equity capital which is significantly larger than companies that do not disclose ESG information [7].

Disclosure *environmental* and *social* be considered important. This disclosure will reflect actual and real corporate social responsibility activities [8]. In addition, having a good relationship will facilitate the company in running its business, so that operational costs or input costs are smaller and reduce risk [9]. However, disclosure *environmental* and *social* alone is not enough, other policies are needed. Because of this public awareness, investment is based *environmental*, *social*, *governance* (ESG) trend in investing in recent years. *Environmental, Social, Governance* (ESG) is a company standard in investment practices which integrates and implements company policies so that they are in line with the concept *environmental*, *social*, and *governance* [10]. Investors believe that there is a reciprocal relationship between portfolios investment with environment and social. First, investors view investment portfolios as having an impact, especially a negative impact, on the environment and social [11]

Company size is the size of a company calculated by the total assets, the number of sales, the average level of sales

and the average total assets. Large companies have greater flexibility to obtain the funds needed to carry out profitable investment opportunities [12]. Companies without realizing it in making changes in achieving performance affect the size of the company. Companies that choose to use debt as a source of funding mean that the company has done so *Financial leverage*. *Leverage* shows the use of debt that plays a role in efforts to improve financial performance due to *leverage* companies that obtain sources of funds by debt can find out the extent to which the loan taken by the company influences the increase in the company's financial performance.

This research is a form of replication and modification of the research by Giannopoulos, et al (2022) which was conducted in Norway with the title "*The ESG Disclosure and the Financial Performance of Nowergian Listed Firms*". The difference between this study and previous research is that this study aims to examine factors that can affect a company's financial performance such as ESG disclosure, company size, and leverage as measured by two proxies, namely *Return On Asset* and *Tobin's Q*. The sample used is companies listed on the Indonesian stock exchange in the period 2018 to 2021.

## II. LITERATURE REVIEW

### 2.1 Agency Theory

*Agency theory* conveys the argument that management's job is to maximize profits for *shareholder*. So that the investment costs for social responsibility practices are greater than maximizing company value, and charging expenses for investment to *shareholder*.

Agency theory can provide an explanation of conflicts of interest that occur in companies. In addition, agency theory also has a relationship with the quality of financial reporting. This happens because the party is given the right to manage (*agent*) obliged to provide all information needed by the principal as a user of financial information to provide accountability values and be able to formulate policies regarding the company [13]

### 2.2 ESG Disclosure

ESG disclosure is a measurement tool in the development of information disclosure on the impact of environmental, social and governance practices implemented by companies. Disclosure of non-financial information can be used as an important indicator in assessing and evaluating the company's performance during the continuity of its operational activities and the impact on these three criteria. Disclosure of ESG According to [14] ESG is a company activity related to the surrounding ecology, interaction with the social environment, and the company's internal control system with the aim of achieving company goals and meeting stakeholder needs.

### 2.3 Company Size

According to [15], states that company size is an increase from the fact that large companies will have large market capitalization, large book values and high profits. Meanwhile, small companies will have small market capitalization, small book values and low profits. The size of the company seen from the total assets owned has a different influence on the performance and value of the company. If the company has large total assets, management is more flexible in using the assets in the company. Total assets the big one will reduce the value of the company if assessed from the side of the company owner. However, when viewed from a management perspective, the ease with which it controls the company will increase the value of the company [16]

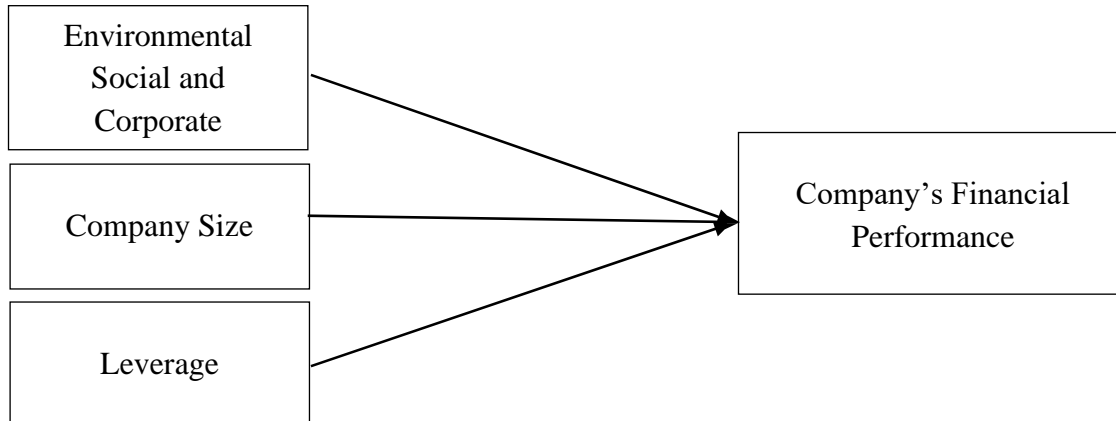
### 2.4 Leverage

Ratio *leverage* is a measure of how much the company is financed with debt. The use of debt that is too high will endanger the company because the company will be included in the category *extreme leverage* (extreme debt), namely the company is trapped in a high level of debt and it is difficult to release the debt burden. Therefore, companies should have to balance how much debt is worth taking and from which sources can be used to pay debts [17].

### 2.5 Financial performance

Financial performance is an indicator of a company's positive achievement in a certain period. The purpose of measuring company performance is to obtain information related to the efficient use of funds, which can help management to make optimal decisions for the company [18]

## 2.6 Framework for thinking and developing hypotheses



### 2.6.1 Effect of ESG disclosure on Financial Performance

Disclosure of ESG is a form of signal given by the company to customers *stakeholder* involved in disclosing information related to the implementation of ESG by the company. In addition, ESG Disclosure is also a tool to gain strong legitimacy in the eyes of society and stakeholders so that with this disclosure it is hoped that a good image for the company can be created [19]. ESG disclosure will reflect how transparent the information provided by the company is, so that if the company operates well it will increase trust and good relations with stakeholders which will increase the company's profit in the future.

Disclosure of non-financial information, such as ESG, is intended as a social investment to meet stakeholder interests which can later help improve company performance. These ESG disclosures add value to the company and thereby reduce business risks [20]. If a company has a high market value, this is in line with increased company performance [21]. The theory and explanation above are in line with the findings of previous research by [22] and [21]. Based on the description above, the first hypothesis of this study is as follows:

H1 : Disclosure of ESG affects financial performance

### 2.6.2 Effect of company size on financial performance

Company size describes the size of a company which can be expressed in total assets or total net sales [23]. Company size is an important factor in determining the company's financial performance. Large companies have several competitive advantages that can have an impact on increasing the profitability of these companies, including companies having market power where large companies can set high prices for their products, and cost savings [24].

Increasing company size will increase the company's financial performance (profit), an increase in the number of assets owned by the company indicates the increasing size of the company [25]. The theory and explanation above are in line with research conducted by [26] which shows that company size has an effect on financial performance. Based on the description above, the second hypothesis of this study is as follows:

H2: Company size has an effect on financial performance

### 2.6.3 Influence Leverage on financial performance

With the ability to handle corporate debt, it can maximize the role of debt as a source of funding to generate profitability so that good corporate performance occurs *leverage* to find out whether the company is able to handle risks arising from the level of debt used by the company. [27]. Research conducted [28]. *Leverage* effect on financial performance. Based on the description above, the third hypothesis of this study is as follows:

H3: *Leverage* effect on financial performance

### III METHOD

#### 3.1 Population and Sample

The population used is companies listed on the Indonesia Stock Exchange in 2018-2021. The sample criteria used in this study are: a). Companies listed on the Indonesia Stock Exchange. b). Companies that disclose ESG values on the Thompson Reuters website or website c). Companies that provide complete financial reports and annual reports for 2018-2021.

#### 3.2 Variable Operational Definition and Variable Measurement

##### 3.2.1 Financial performance

###### a. Return on Asset

Return on Assets is an instrument that is commonly used to measure the profit earned by a company. Return on Assets is calculated using the formula [22]:

$$\text{Return on Assets} = \frac{\text{Net Profit}}{\text{Total Assets}}$$

###### b. Tobin's Q

Tobin's Q is an instrument used to measure the value of a company. Tobin's Q is calculated using the formula [2]:

$$\text{Tobin's Q} = \frac{\text{Total assets} + \text{market capitalization} - \text{net worth}}{\text{Total Assets}}$$

### 3.2.2 ESG Disclosure

ESG was measured using the Thomson Reuters Eikon™ ESG Score.

### 3.3.3 Company Size

Company size is measured by indicators such as sales, capital, and total assets [29]. Company size is calculated by the formula [30]:

$$\text{Company Size} = \ln(\text{Total Assets})$$

### 3.3.4 Leverage

Leverage is a ratio that compares between debt and assets, leverage informs the company's capital structure originating from loans [31]. Leverage is calculated by the formula [32]:

$$\text{Leverage} = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

## IV. Figures and Tables

### 4.1 Research Results and Discussion

#### 4.1.1 Panel Data Estimation Model Selection Test

Analysis with panel data is used to find out the situation regarding the relationship of the independent variables of ESG Disclosure, Company Size, Leverage and the dependent variable of financial performance

Model *Common Effect Model (CEM)*, *Fixed Effect Model (FEM)* and *Random Effect Model (REM)* each needs to be tested using the panel data regression method using Eviews 9. Testing *Return on Asset* in the Chow Test and Hausman Test selected models *Fixed Effect* and models *Random Effect*, it is necessary to test the hypothesis with Test *Lagrange Multiplier* in selected tests *Random Effect* model. So the results of testing the panel data regression model recommend use *Random Effect* The model to be used. And testing *Tobin's Q* in the Chow Test and Hausman Test selected models *Fixed Effect* . So the results of testing the panel data regression model recommend use *Fixed Effect* The model will be used for further analysis in this study

4.1.2 Panel Data Multiple Regression Analysis

Table 4.1.2 Multiple Regression AnalysisROA

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.899190	0.286974	3.133354	0.0020
X1_ESG	0.000420	0.000483	0.870840	0.3851
X2_COMPANY_SIZ	-0.026216	0.009234	-2.838976	0.0051
E				
X3_LEVERAGE	-0.031929	0.015859	-2.013319	0.0457

Source: eviews processed data

Based on the results of data processing in table 4.1.2, the following is the result of the multiple linear regression analysis equation, namely:

$$Y = 0,899190 + 0,000420X1 - 0,026216X2 - 0,031929X3 + e$$

Table 4.1.2 Multiple Regression Analysis  
*Tobin's Q*

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	20.49973	5.532554	3.705292	0.0003
X1_ESG	-0.001333	0.004865	-0.274060	0.7845
X2_COMPANY_SIZ	-0.620918	0.174801	-3.552137	0.0005
E				
X3_LEVERAGE	0.384323	0.114244	3.364042	0.0010

Source: eviews processed data

Based on the results of data processing in table 4.1.2, the following is the result of the multiple linear regression analysis equation, namely:

$$Y = 20,49973 - 0,001333X1 - 0,620918X2 + 0,384323X3 + e$$

4.1.3 F Test

Table 4.1.3 F Test ResultsROA

Variable	Prob (F-Statistic)
Return on Asset	0,003647

Source: eviews processed data

Based on the results of the research above, it shows that the probability value (F-statistic) is 0.003647. The probability value (F-statistic) is smaller than alpha 5% ( $0.003647 < 0.05$ ) indicating the ESG variable, company size, *Leverage* jointly influence *Return on asset*

Table 4.1.3 F Test Results

*Tobin's Q*

Variable	Prob (F-Statistic)
Tobin's Q	0,000000

Source: eviews processed data

Based on the results of the research above, it shows that the probability value (F-statistic) is 0.000000. The probability value (F-statistic) is greater than alpha 5% ( $0.000000 < 0.05$ ) indicating the ESG variable, firm size, leverage has an effect on *Tobin's Q*

4.1.4 T Test

Based on table 4.1.2 ROA it is concluded that:

The first hypothesis (H1) the effect of ESG disclosure on *Return on Asset* produces a significance value of  $0.3851 > 0.05$ , then H1 rejected. This means that ESG has no effect on *Return On Asset*. The second hypothesis(H2) the effect of company size on *Return on Asset* produce a significance value of  $0.0051 < 0.05$ . so that H2 accepted. This means that the size of the company has an effect on *Return on Asset*. The third hypothesis (H3) influence *leverage* to *Retun on Asset* produces a significance value of  $0.0457 < 0.05$ ..until H3 accepted. This means that leverage has a significant effect on *Return on Asset*.

Based on table 4.1.2 Tobin's Q it is concluded that:

The first hypothesis (H1) the effect of ESG disclosure on *Tobin's Q* produces a significance value of  $0.7845 > 0.05$ , so that H1 rejected. This means that ESG has no effect on *Tobin's Q*. The second hypothesis (H2) the effect of Firm Size on *Tobin's Q* produces a significance value of  $0.0005 < 0.05$ , then H2 accepted. This means that the size of the company has an effect on *Tobin's Q* . The third hypothesis (H3) influence *leverage* to *Tobin's Q* produces a significance value of  $0.0010 < 0.05$ , then H3 accepted. This is meaning ful *leverage* effect on *Tobin's Q*.

4.1.5 Coefficient of Determination

Table 4.1.5 Test Results for the Coefficient of DeterminationROA

Return on Asset	Adjusted R-squared
	0,062022

Source: eviews processed data

Based on the results of the research above, it shows that the Adjusted R-squared is 0.062022. This means that 6.2% *Return on Asset* can be explained by ESG, Firm Size, *Leverage*, while the remaining 93.8% is explained by other variables not included in this research model.

Determination Coefficient Test Results  
Tobin's Q

Tobin's Q	Adjusted R-squared
	0,000000

Source: *evIEWS processed data*

Based on the results of the research above, it shows that the Adjusted R-squared is 0.952234. This means that 95.2% of Tobin's Q can be explained by ESG, Company Size, *Leverage*, while the remaining 4.8% is explained by other variables not included in this research model.

## 4.2 Discussion of Analysis Results

### 4.2.1 Effect of ESG Disclosure on Financial Performance

The results of the data analysis show that the ESG Disclosure variable has no effect on Financial Performance which is proxied by *Return on Asset*. This is caused by companies minimize spending related to environmental and social practices and divert them to maximize profits for owners. This condition occurs because ESG practices will only provide results when investment is at a certain level and or achievements in practice have been made, so that any spending on ESG practices will not affect *Return on asset*. The results of this study are in line with the research by [33] which states that ESG has no effect on *Return on Asset*.

The results of the data analysis show that the ESG Disclosure variable has no effect on financial performance which is proxied by *Tobin's Q*. This is because shareholders consider investment to be greater than maximizing firm value. Companies assume that setting goals other than maximizing profits will hinder achievement *competitive sustainability advantage*. The results of this study are not in line with the research of [33], which states that ESG has no significant effect on Tobin's Q.

### 4.2.2 Effect of Firm Size on Financial Performance

The results of data analysis show that the variable firm size has an effect on financial performance which is proxied by *Return on Asset*. This indicates that any increase in firm size will decrease *Return on Asset* in these companies which can be caused by the large costs for maintaining large assets and a large operational scope because the increase in assets is not matched by the amount of profit earned in the company which means the company's lack of effectiveness in managing its assets to increase profitability in this study to measure financial performance. Large companies will attract investors to invest in these companies because the risk level of company uncertainty is very small and large companies will find it easier to obtain funds from outsiders because they gain the trust of the public. The results of this study are in line with the research of [26] which states that company size has an effect on financial performance.

The results of data analysis show that the variable firm size has an effect on financial performance which is proxied by Tobin's Q. This happens because investors think that companies with large total assets tend to set retained earnings higher than the dividends distributed to shareholders. Companies with assets and large companies that have loans as a source of funds do not always share profits with shareholders but do retained earnings to be used as capital again, so companies that retain profits rather than distribute them as dividends can affect share prices and company value. The results of the research are in line with the research of [2] which states that company size effect on *Tobin's Q*.

#### 4.2.3 Influence *Leverage* on financial performance

The results of the data analysis show that the *Leverage* variable has an effect on financial performance which is proxied by *Return on Asset*. This is due to levels *leverage* A high debtor will have a high risk which is marked by a greater cost of debt. If proportion *leverage* If the company does not stop it, it will cause a decrease in profitability because the use of debt creates a fixed interest expense. So that companies that finance their assets with debt, their profitability will decrease because the company must meet the burden that must be paid from using the debt. The results of the research are in line with the research of [33], which states that *Leverage* negative effect on *Return on Asset*.

The results of the data analysis show that the *Leverage* variable has an effect on financial performance which is proxied by *Tobin's Q*. This happens on the grounds that the existence of debt will result in a reduction in income tax. Tax deductions can increase profits so that funds can be allocated by companies to make investments or distribute dividends to shareholders. This is a positive signal for investors to invest so that it has an impact on increasing the supply of shares in the capital market and is able to increase the value of the company. The results of this study are in line with the research of [2] which states that *Leverage* effect on *Tobin's Q*

## V. Conclusion

This study aims to analyze the effect of disclosure of ESG, Firm Size, and *Leverage* on the company's financial performance from 2018 to 2021. Based on the results of the analysis and discussion described previously, it can be concluded that, (a) ESG Disclosure has no effect on Financial Performance proxied by *Return on Asset*. As for the significance value is  $0.3851 > 0.05$ , (b) ESG disclosure has no effect on financial performance proxied by *Tobin's Q* as for the significance value is  $0.7845 > 0.05$ , (c) Company Size has an effect on Financial Performance by *Return on Asset*. As for the significance value is  $0.0051 < 0.05$  (d) Company size has an effect on Financial Performance which is proxied by *Tobin's Q*. As for the significance value is  $0.0005 < 0.05$ . (e) *Leverage* affects Financial Performance proxied by *Return on Asset*. The significance value is  $0.0457 < 0.05$ . (f) *Leverage* has an effect on financial performance which is proxied by *Tobin's Q*. The significance value is  $0.0010 < 0.05$ .

### Limitations

In this study there are several limitations that may affect the results of the study, namely:

1. This study uses companies that disclose ESG so that the companies studied are very varied, not distinguishing between financial companies and non-financial companies

### Suggestion

Based on the conclusions and limitations contained in this study, several suggestions can be put forward that can be taken into consideration in further research, namely:

1. For further research it is recommended to group in certain sectors

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