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Impact of Community, Governance, Environment, Employees Performance on Firm Value and Profitability as mediating variable

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ABSTRACT

This study analyzes the effect of ESG performance through community, governance, environment and employee indicators on company value and profitability as mediating variables in ESG leader companies listed on the IDX with an observation period of 2018 to 2022. The sample of this study was 17 companies or 85 observation data. We utilized the statistical package SMARTPLS analysis to assess both the direct and indirect effects. The hypothesized variables used content analysis, using binary (0 and 1) coding, to measure the extent of sustainability performance disclosure according to the Global Reporting Initiative (GRI) framework. This study found that ESG performance had a negative effect on company value. ESG performance also had a negative impact on profitability. Profitability had a positive impact on company value.

INTRODUCTION

Environmental issues, social issues are also now a global concern, reported by the United Nation Foundation there are several social issues that must be considered such as poverty alleviation, gender equality issues and women's rights, as well as several humanitarian crises and conflicts that are developing. In 2022, 274 million people are estimated to need humanitarian assistance, an increase of almost 20% from the record high in 2021. Digging into the data reveals a number of disturbing humanitarian cases such as relocation, famine, increasing intersections between issues such as climate and famine with conflict, and increasing authoritarianism. ESG is a non-financial indicator that describes a company's ability to conduct sustainable business by considering environmental, social, and governance aspects (Melinda & Wardhani, 2020). Companies that disclose ESG are companies that not only focus on increasing company profits but also carry out responsibilities towards environmental, social, and corporate governance aspects.

The implementation of effective ESG disclosure can provide benefits in supporting improved company performance. According to The Association of Chartered Certified Accountants, the implementation of environmental, social, and governance disclosures can improve learning for companies to identify business risks and innovations, improve company reputation, improve management quality through transparency, maintain long-term business sustainability, and support financial performance. Companies are recommended to carry out ESG practices because they can increase competitive advantage so as to increase company value as well (Cakranegara & Sidjabat, 2021) in addition, for stakeholders, company performance is very important (Triyani et al., 2020). The competitive advantage obtained from the effective implementation of ESG is that it can build customer loyalty, make company operations sustainable, attract investors and lenders, and improve financial performance.

Financial indicators such as profitability ratios can assess a company's performance and financial performance assessment is very important to determine the success of a company. Return on assets is a financial ratio that measures a company's profitability by showing how much profit is obtained from the total assets owned by the company. This ratio measures the effectiveness of the use of wealth to generate company profits. ROA is a financial ratio that predominantly influences the company's financial earning power.

In carrying out all business activities it is important to consider the wishes of stakeholders so as to gain support for the sustainability of the company. According to Brammer & Pavelin, (2004) and Kuningan (2006) companies face challenges in managing their relationships with stakeholders' interests, such as differences in expectations between stakeholders. To overcome this challenge, companies can show financial and non-financial information to stakeholders to identify which is considered the best way (Harmoni, 2013).

The author chose companies included in the ESG Leaders Index as research objects, this is because social and environmental issues are currently a public concern. The ESG Leaders Index is a stock index published by the Indonesia Stock Exchange which contains shares of companies with the highest environmental, social, and governance disclosure performance. The performance assessment uses ESG Risk which assesses how much risk to the company's economic value is influenced by environmental, social, and governance factors. The reason for choosing the ESG Leaders Index is because companies with high ESG practices are of particular concern to investors who support green business and sustainable businesses with the implementation and assessment of environmental, social, and governance performance. This is also supported by several government policies and regulations that require companies. This research was conducted on ESG leader companies listed on the IDX with an observation period from 2018 to 2022, to see the impact of ESG on company value with profitability as a mediating variable.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Institutional setting

The Indonesian government has set a goal to achieve a green economy by 2025, which includes reducing greenhouse gas emissions, increasing the use of renewable energy, and promoting sustainable development. The GRI is a widely used framework for sustainability reporting that provides guidelines on what to report and how to report ESG information. The OJK has developed guidelines for banks to integrate ESG considerations into their lending decisions. Financial Services Authority (OJK) Regulation No. 35/POJK.07/2017, this regulation requires banks and other financial institutions to prepare sustainability reports. Capital Market and Financial Institution Supervisory Agency (Bapepam-LK) Regulation No. I-A/13/2008, this regulation requires listed companies to prepare sustainability reports. The regulation, namely Article 74 of Law No. 40 of 2007 concerning Limited Liability Companies (PT), states that companies that carry out their business activities in the field of and/or related to natural resources are required to carry out social and environmental responsibilities.

Saygili et al., (2022) and Kim & Li, (2021) found that environmental, social, and governance performance can improve a company's financial performance as proxied by ROA, in contrast to research conducted by Husada & Handayani (2021), and Juliandara et al.,

(2021) which found that environmental, social, and governance performance had no impact on the company's financial performance. Problem Formulation:
1. Does environmental performance affect firm value?
2. Does social performance affect firm value?
3. Does governance performance affect firm value?
4. Does ESG affect firm value?
5. Is profitability able to mediate the relationship between ESG and firm value?

LEGITIMASI THEORY

Legitimacy theory emphasizes that companies continue to strive to ensure that they have carried out company operations in accordance with the norms of the community in the environment where the company is located, they (the company) ensure that their operational activities can be accepted by outsiders as something "legitimate" (Wanny et al., 2016). When a company makes social disclosures, the company will feel that the existence and operations of its company will receive status from the community or place where the company is located, so it can be said that the company is legitimate (Oktary, 2014). This is in accordance with the idea expressed by Octavia (2012) that legitimacy is the idea that in order for an organization to operate successfully, it must pay attention to the norms and rules that are widely accepted by society.

METHODS

The data used in this study are secondary data, taken from annual reports and sustainability reports in 2018-2022. The sample of companies listed in the ESG Leaders Index is 17 companies with 85 observation data. We utilized the statistical package SMARTPLS analysis to assess both the direct and indirect effects.

Result

This study was conducted on ESG leaders companies listed on the IDX with an observation period of 2018 to 2022, to see the impact of ESG on company value with profitability as a mediating variable. The results of the model test in this study can be seen as follows in Table 1:

Table 1. The result of the model test

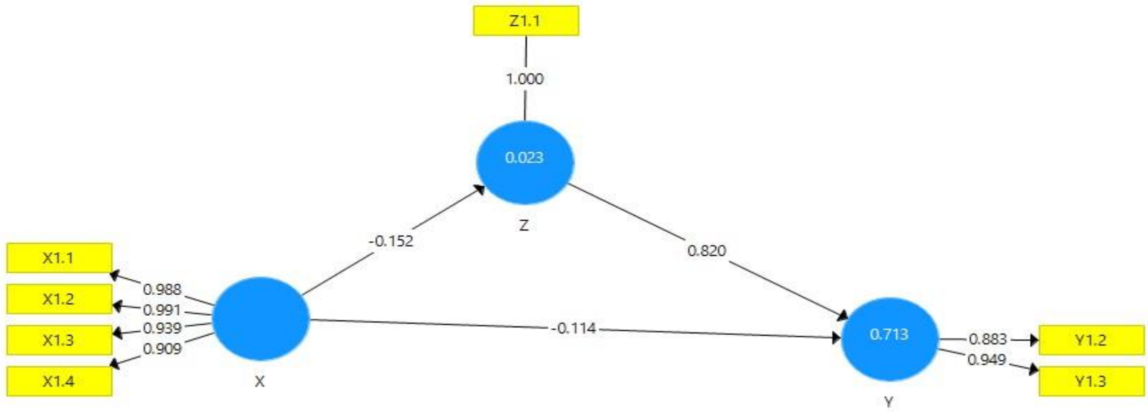
	Cronbach's Alpha	rho_A	Composite Reliability	Average Variance Extracted (AVE)
ESG	0,969	0,981	0,978	0,917
Firm Value	0,817	0,911	0,913	0,840
Profitability	1,000	1,000	1,000	1,000

From the research results, it is known that all variables have a Cronbach's Alpha value above 0.5 and an Average Variance Extracted (AVE) value greater than 0.7 so that all variables and indicators have met the reliability requirements.

Tabel 2. Fornell-Larcker Criterion

	ESG	Firm Value	Profitability
ESG	0,957		
Firm Value	-0,239	0,917	
Profitability	-0,152	0,837	1,000

Based on the results of the discriminant validity test, the correlation value of each variable is greater than the variable itself when compared to other variables, so it can be concluded that the model has met the discriminant requirements.



Tabel 3. R Square

	R Square	R Square Adjusted
Firm Value	0,713	0,706
Profitability	0,023	0,011

From table 3 above, it can be seen that the ESG variable affects the Company's value by 0.713 or 71.3 percent. The rest is influenced by other variables outside this study. ESG affects profitability by 0.023 or 2.3%, the rest is influenced by other factors that have a greater influence.

Tabel 4. hypothesis test table

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values	Keterangan
X -> Y	-0,114	-0,117	0,043	2,693	0,007	Supporting
X -> Z	-0,152	-0,156	0,073	2,085	0,038	Supporting
Z -> Y	0,820	0,813	0,043	19,105	0,000	Supporting

Hypothesis testing or model testing is carried out using smart PLS as shown in table 4 so that the impact of ESG on company value can be known with Profitability as a mediating variable.

Environmental performance affect company value
The ESG variable has a negative path coefficient of -0.114 on the Company's value, with a P Value of 0.007 <0.05 so that it has a significant negative impact on the Company's value. This means that if ESG performance increases, the Company's value will decrease. The results of this study support the findings of Ah, at.al (2024) and Wahyuningtyas et al., (2022) ESG performance has a positive and significant effect on the value of non-BUMN companies in China. The results of the study showed that the implementation of ESG performance has a significant impact on company value because ESG performance is very effective in building a company's reputation, in addition ESG Performance can reduce company risk and can increase access to capital and better financial performance.
Environmental performance affect to Profitability

The ESG variable on profitability has a p value of 0.038 <0.05 and a path coefficient of -0.152, meaning that ESG performance has a negative impact on the company's profitability. The higher the ESG performance disclosed in the annual report, the lower the company's profitability. The results of this study support the findings of Paolo Agnese (2024) and Wahyuningtyas et al., (2022) Banks that have good ESG ratings tend to have good profitability as seen from return on assets, return on equity and net interest margin. The results of the study show that ESG has a significant impact on profitability where the existence of ESG can reduce the company's operational costs due to continuous product innovation in involving optimal workforce.
Profitabilitas affect company value

Profitability to the Company's value has a positive path coefficient and a p value of 0.000 <0.05, meaning that if profitability increases, the Company's value also increases. The results of this study support the findings of Ararat et.al 2017 where companies that have high profitability have an impact on the high value of the company. The results of the study show that profitability affects the value of the company, this is evidenced by the many investors who are interested in companies that have good profit growth to make investments and have positive financial performance.**Pengaruh Mediasi ESG Performance terhadap Nilai Perusahaan dengan Profitability sebagai intervening variable**

To determine the influence of ESG Performance mediation on company value with profitability as a mediating variable, see the following table:

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values
X -> Z -> Y	-0,124	-0,127	0,059	2,093	0,037

The test results obtained a coefficient value of -0.124, which means that the existence of profitability has a negative relationship between ESG performance and company value. This study also found that profitability is able to significantly mediate the relationship between ESG performance and company value because it has a Sig value <0.05. The results of this study support the findings of Aydoğmuş at.al (2022) where ESG performance has a significant relationship with company value and company profitability. Profitability is very important considering that the company's goal is to create the greatest possible profit. ESG performance reflects the company's social performance can create value for society and shareholders (Wahyuningtyas et al., 2024)

CONCLUSION

The purpose of this study is to examine the impact of ESG performance on firm value with profitability as an intervening variable. The findings of this study are that ESG performance has a significant effect on firm value, as well as ESG performance on firm value. This study also found that profitability has a significant effect on firm value. Profitability is able to significantly mediate the relationship between ESG performance and firm value. ESG performance is very important in increasing firm value because it can improve the company's reputation, so managers need to improve ESG performance, the results of the study show that if ESG performance is increased, it will increase the value of the company. This study is very useful for economics, especially accounting science. Where the implementation of good ESG performance can increase the value of the company so that it can be used as a reference by company managers, researchers and academics in developing accounting science.

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