

THE EFFECT OF ESG PERFORMANCE ON THE FINANCIAL PERFORMANCE OF MANUFACTURING COMPANIES LISTED IN THE INDONESIAN

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ABSTRACT

This study was conducted to analyze the effect of environmental, social, and governance (environmental, social, and governance (ESG) performance on the company's financial performance. The company's financial performance is proxied by using Return On Assets. The population in this study are manufacturing companies listed on the Indonesia Stock Exchange in the 2015-2019 period. The sampling technique used purposive sampling to obtain a total of 13 manufacturing companies whose annual reports were published on idx.co.id and disclosed environmental, social, and governance scores on Bloomberg. The analytical method used is panel data regression using the E-views 9 program. The results of this study indicate that social performance, governance performance and ESG performance have a positive and significant effect on the company's financial performance while environmental performance has a negative and insignificant effect on the company's financial performance.

Keywords: Environmental Performance, Social Performance, Governance Performance, ESG Performance, Financial Performance.

The Effect of ESG Performance on The Financial Performance of Manufacturing Companies Listed in The Indonesian

Received
July 21st 2021
Review
November 23th 2021
Publish
December 31st 2021



AFEBI Management
and Business
Review
(AMBR)

P-ISSN **2548- 530X**
E-ISSN **2548-5318**

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Maintaining the long-term sustainability of the company by adhering to the guidelines for corporate governance is the key to increasing the company's value which is increasingly optimal for all company stakeholders. Especially for companies that pay attention to environmental, social, and governance issues (Environmental, Social, Governance/ESG) can attract investors to make socially responsible investment decisions (De Lucia et al., 2020). Because investors realize that companies that ignore ESG performance are not unlikely to have an impact on company performance. Corporate Social Responsibility (CSR) as the main element of company stakeholder management is required to report the disclosure of information on sustainability reports on environmental, social, and governance (ESG) issues Velte (2019).

Based on the results of the Globescan survey and the Global Reporting Initiative (GRI) regarding the level of public trust in the disclosure of information in the 2020 sustainability report, it showed a significant increase reaching an average of 51%. This result increased sharply when compared to the same survey result in 2003 which was 30%. Of the 27 countries surveyed, the highest level of public trust in Indonesia reached 81% as well as being the first to beat China's position, which previously stood at 80% to 73%.

Meanwhile, Indonesia rose 2% from the previous achievement in 2016 of 79%, which means that the need for disclosure of sustainability information is increasingly needed because investors and other stakeholders have begun to disclose the performance of Environmental, Social, and Governance (ESG) as an indicator of the company's strength. This situation is also supported by observations on the global stock market where companies with good ESG performance are better able to maintain their performance. This was also marked by the launch of a new index themed IDX ESG Leaders (ESGL) by the Indonesia Stock Exchange (IDX).

In practice, there are still problems that arise in Indonesia related to the implementation of company operations that do not pay attention to environmental, social and governance (ESG) conditions around them, especially for companies whose business activities are related to natural resource management. Some of these companies are attached in Table 1 below.

Table 1.

List of Manufacturing Companies That Have Problems Regarding Financial Performance, Environmental, Social, and Governance DEA

Company Name	Problems
PT. Kalista Alam Tbk.	Received an environmental compensation sanction of 300 billion for being proven to have burned the forest in the clearing of its area.
PT. Eterindo Wahanatama Tbk.	The company does not disclose its environmental performance in its annual report.
PT. Selamat Sempurna Tbk.	The company does not disclose its environmental performance in its annual report.
PT. Mukomuko Indah Lestari Tbk.	Air pollution that afflicts the community around the company
PT. Kabelindo Tbk.	Not making changes in environmental management because in 2012 it did not get the environmental performance predicate.

Some of these problems are evidence that there are still companies that only focus on achieving financial performance and forgetting their responsibilities to environmental, social, and governance (ESG) performance. Deviations from the business ethics that have been determined by the company as implementing good governance are not obeyed by the company's own internal parties. This can have an impact on the business climate in Indonesia such as its effect on stock prices and the good reputation of the company. Table 2 illustrates how the relationship between environmental, social, and governance (ESG) performance on the financial performance of manufacturing companies listed on the Indonesia Stock Exchange for the period 2015 to 2019.

Table 2.

Mean ROA, ENS, SOS, GS, ESG from 13 Manufacturing Companies listed in BEI for the 2010-2015 Period

Ratio	2015	2016	2017	2018	2019
ROA	10,76	11,78	9,98	10,78	9,17
ENS	19,75	20,83	23,51	26,61	27,31
SOS	33,60	35,49	38,19	39,95	42,78
GS	54,12	56,87	54,46	57,14	58,24
ESG	30,79	32,55	35,36	35,36	38,21

Based on Table 2, it is found that there is an inconsistent relationship between ROA as a proxy of financial performance and environmental, social, governance (ESG) performance. The average financial performance of manufacturing companies listed on the Indonesia Stock Exchange fluctuates every year from 2015 to 2019. Even though the greater the ROA indicates the company's financial performance is getting better, because the returns are getting bigger so that the level of profitability also increases. While the other variables continue to increase. In this case, there has been a gap in the relationship between variables. Should the higher disclosure of environmental, social and governance (ESG) performance is expected to lead to an increase in the results of the company's financial performance Velte (2019).

Continuing with this statement, Buallay (2019) said that the disclosure of environmental, social and governance (ESG) performance can reduce the level of business risk that may occur due to practices related to the surrounding social environment carried out by the company and will attract the attention of stakeholders because they view the company as have a good level of sustainability so that they are able to gain support from the company's stakeholders through the trust given to equity participation and the use of company products and services. However, it appears in the table that the continuous improvement in environmental, social, governance, and ESG performance in total is not accompanied by an increase in financial performance as proxied by Return on Assets (ROA), what happens is that the average percentage of ROA is inconsistent. experienced an increase and decrease until it finally declined again in 2019.

Several previous studies have discussed the effect of environmental, social, and governance (Environmental, Social, and Governance/ESG) performance on the company's financial performance. The research results obtained vary, but each researcher has his own explanation behind the differences in existing research results. Ladyve et al. (2020) and Zainab & Burhany (2020) found that environmental performance had a positive and significant effect on the company's financial performance, while Alareeni & Hamdan (2020) found a negative and significant effect on the company's financial performance. Research on the effect of social performance on the company's financial performance conducted by Velte (2019) found a positive and significant effect on the company's financial performance. Meanwhile, Buallay (2019) found a negative and significant effect on the company's financial performance. Previous research on the effect of governance performance on the company's financial performance still found differences in results. The results of the research by Sitanggang & Ratmono (2019) found that corporate governance had a positive and significant effect on the company's financial performance, while Buallay (2019) found a negative effect on the company's financial performance. Previous research on the effect of Environmental, Social, and Governance (ESG) performance on the company's financial performance conducted by Safriani, M. N dan Utomo (2020) found that ESG performance had a positive and significant effect on the company's financial performance. However, different results were shown by Buallay et al. (2020) that the performance of Environmental, Social, and Governance (ESG) has a negative and significant effect on financial performance. While Junius et al. (2020) found that the performance of Environmental, Social, and Governance (ESG) had no significant effect in a negative direction. Based on the explanation above, it is known that there are variations in the results of previous studies and this creates a gap that needs to be identified further through this research, the following questions are formulated:

- (1) How does environmental performance affect the financial performance?
- (2) How does social performance affect the financial performance?
- (3) How does governance performance affect the financial performance?
- (4) How does ESG performance affect the financial performance?

LITERATURE STUDY

Stakeholder Theory extends to all stakeholders, so that it does not only focus on shareholders but also on investors or owners of corporate responsibility (Donaldson & Preston, 1995). Value and satisfaction with coalition partners (stakeholders) are part of business activities that lead to the company's long-term success (Freeman, 2004).

Legitimacy Theory asserts that the company seeks to pay attention to all its activities in accordance with the values and norms that exist in the society where the company operates with the aim of gaining legitimacy from its social environment (Carlson & Bierman, 1966).

The Echelon Theory means that the achievement of organizational goals such as the achievement of strategy and company performance is a reflection of the characteristics of managerial skills led by organizational leaders (Hambrick, 1986).

Signaling theory was put forward by Arkelof in 1970 that in a transaction the parties involved in it have different levels of information (information asymmetry) from each other and are valuable. This theory also suggests the importance of information issued by the company to investment decisions.

Hypothesis Development

The Effect of Environmental Performance on the Company's Financial Performance

Ladyve et al. (2020) also found a positive and significant relationship between environmental performance and company financial performance. If the environmental performance is good, it can affect the financial performance which will increase, and vice versa. Information on environmental performance is important for the company to be known by stakeholders in order to avoid demands from the community and stakeholders, so that it will affect the financial performance and sustainability of the company. The same thing was also expressed by Zainab & Burhany (2020) that good environmental performance can be evidence that the company can grow sustainably and in the long term, because it reflects that the company has fulfilled its responsibilities and can avoid damage problems. environment that can lead to greater expenses and even closure of the company's business activities.

H1: Environmental performance has a positive effect on the company's financial performance.

The Effect of Social Performance on the Company's Financial Performance

Danovan & Gibson (2000) say that based on legitimacy theory, one opinion in the relationship between profitability and social performance is that when the company has a high level of profit, (management) the company considers it unnecessary to report things that can interfere with information about the company's financial success. And conversely, when profitability is low, they expect users of the report to read good news about the company's performance, such as in the social sphere, thus investors will continue to invest in the company. According to the theory of legitimacy, companies will try to build and maintain relationships with the environment, social, and politics in which the company operates (Ismail & Laksito, 2020). This is done so that the company gets strong legitimacy so that the company can run alive regardless of the aspect of the company's financial performance (Gray et al., 1995). Therefore the company will build and maintain corporate social relations by having to carry out Corporate Social Responsibility (CSR) in the social sphere and as a form of responsibility to develop the surrounding environment and to gain legitimacy so that the company continues to survive. This statement is supported by the results of research by Velte (2019) which found that successful CSR involvement will lead to an increase in financial performance with positive and significant results.

H2: Social performance has a positive effect on the company's financial performance.

The Effect of Governance Performance on the Company's Financial Performance

Companies that implement good corporate governance are expected to have good financial performance so that the company's stock price will rise and can also have an impact on increasing company value (Agustini & Gunadarma, 2015). Based on signaling signalling theory, the results of implementing good governance are positive information for stakeholders. This is because the results of good corporate governance show the company's management commitment to evaluate and improve in line with improving the company's financial performance (Mumtazah & Purwanto, 2020). In line with this, research conducted by Sitanggang & Ratmono (2019) found that corporate governance has a positive effect on the company's financial performance, meaning that the better corporate governance is implemented by the company, the better the company's financial performance can be with the indicator used, namely are audit committee size, audit committee meeting activity, proportion of independent commissioners, and audit quality.

H3: Governance performance has a positive effect on the company's financial performance.

The Effect of ESG Performance on the Company's Financial Performance

Disclosure of ESG information is a form of communication between the company and the stakeholders involved. Safriani, M. N dan Utomo (2020) in their research said that the company will seek to disclose information on its business activities in order to change the views and expectations of stakeholders. ESG disclosure is used by companies as a tool to gain strong legitimacy in the eyes of the community and stakeholders. Thus, it is expected to create a good image for the company for a disclosure made. Buallay (2019) in his research states that a positive ESG disclosure score is believed to bring greater asset returns. The same thing was also expressed by Velte (2017) that ESG performance has a positive linear impact on ROA. Likewise, the stakeholder theory and the legitimacy theory that have/ has been described previously that companies are required to provide benefits to all company stakeholders so that they are not only oriented towards profitability but in practice must be in accordance with social norms and values that develop in the community where the company is located.

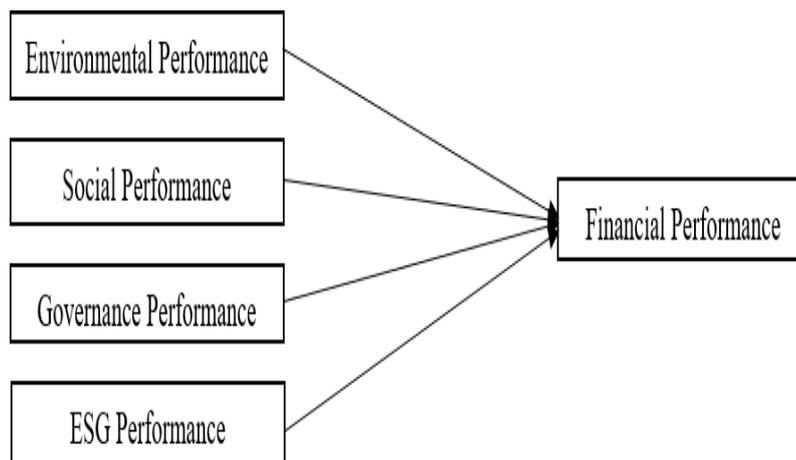
H4: ESG performance has a positive effect on the company's financial performance.

RESEARCH METHODOLOGY

Source of Data and Sample

The data used in this research are secondary data consisting of the annual reports of audited sample manufacturing companies listed in the Indonesian Stock Exchange (BEI) from 2015 – 2019. These data were taken from the Bloomberg and also BEI (www.idx.co.id).

Samples for this research were taken using the purposive sampling method. The criteria included manufacturing companies are listed in BEI continuously from 2015 – 2019, sample companies that present complete and consecutive annual reports data (no missing data) from 2015- 2019 and sample companies that publish the Environmental Disclosure Score, Social Disclosure Score, Governance Disclosure Score, ESG Disclosure Score completely and consecutively (no missing data) by Bloomberg from 2015-2019. These criteria found 13 manufacturing companies. The other variables included in this research are given in the framework as shown in Figure 1



The Effect of ESG Performance on The Financial Performance of Manufacturing Companies Listed in The Indonesian

Figure 1. Theoretical Framework

Definition of Operational Variable

The independent variable is a variable that affects or causes a change or emergence of the variable. In this research are Environmental Performance, Social Performance, Governance Performance, and ESG Performance. variable is a variable that is influenced or caused by the presence of independent variables. In this study, financial performance is proxied by return on assets.

Method of Analysis

The Analysis method used is panel data regression using the E-views 9 program. Where one of the three models in the panel data will be selected, namely, the Common Effect Model, Fixed Effect Model, and Random Effect Model. The regression equation model is as follows:

$$ROA = \alpha + \beta_1ENS + \beta_2SOS + \beta_3GS + \beta_4ESG + e$$

Table 3.
Variable and
Operational
Definition

Variable	Description	Scale	Measurement
Return on Asset(ROA)	The Ratio between profit before tax and total asset (Brigham, Eugene F., & Houston, 2010).	Ratio	$ROA = \frac{\text{Net Profit After Tax}}{\text{Total assets}} \times 100\%$
Environmental Performance (ENS)	A pillar score that measures a company's impact on living natural systems, including air, land and water (Velte, 2019).	Ratio	The percentage of the number of items issued by the company through the environmental disclosure score in the Bloomberg terminal with a value in the range of 0 to 100.
Social Performance(SOS)	A pillar score that measures a company's capacity to generate trust and loyalty with its workforce, customers and communities (Velte, 2019).	Ratio	The percentage of the number of items issued by the company through the social disclosure score in the Bloomberg terminal with a value in the range of 0 to 100.
Governance Performance(GS)	A pillar score that measures a company's systems and processes that ensure that board members and executives act in their best interests as long-term shareholders (Velte, 2019).	Ratio	The percentage of the number of items issued by the company through the governance disclosure score in the Bloomberg terminal with a value in the range of 0 to 100.
ESG Performance(ESG)	Environmental, social, and governance performance scores compiled by the Bloomberg ESG Database (Velte, 2019).	Ratio	The percentage of the number of items issued by the company through the ESG disclosure score in the Bloomberg terminal with a value in the range of 0 to 100.

Source: Books and Journals

RESULT AND DISCUSSION

Descriptive Statistics

Descriptive statistics is aimed at providing general description of the data obtained such as minimum, maximum, mean, median, standard deviation. The following are the results of statistical descriptive analysis of research variables using the E-views 9 program in table 4.

Table 4.
Result of Descriptive
Analysis

	ENS	SOS	GS	ESG	ROA
Mean	22.62655	39.22846	58.86369	31.83231	17.14877
Median	21.70500	38.60000	57.14000	29.77000	15.34000
Maximum	55.81400	63.16000	78.02000	50.00000	41.01000
Minimum	2.326000	15.54000	48.20000	19.42000	1.220000
Std. Dev.	13.84688	13.18661	7.003027	8.672169	10.69213
Observations	65	65	65	65	65

Based on the data in table 4, it can be concluded that the number of observations in this study was 65 observational data which were obtained from 13 samples of research objects conducted in the 2015 to 2019 period. The variables ROA, ENS, SOS, GS, ESG had an average value of higher than the standard deviation. This shows that the data has a small distribution so that it indicates that the data is good datas.

Model Selection Test
Langrange Multiplier Test (LM Test)

The following are the results of the LM Test using the E-views 9 program:

	Test Hypothesis		
	Cross-section	Time	Both
Breusch-Pagan	1.913298 (0.1666)	1.178311 (0.2777)	3.091609 (0.0787)

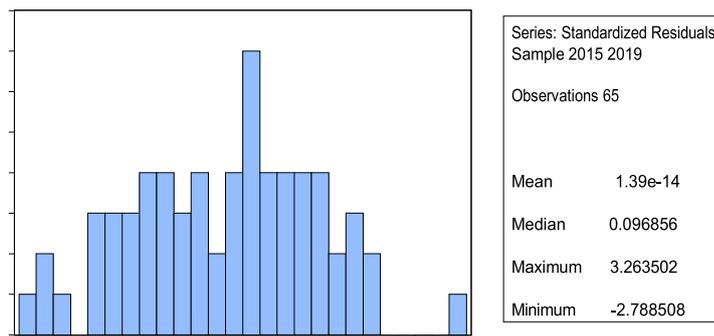
Source: Author's calculation

Based on the LM Test, it is known that the statistical LM value is 1.913298 and the probability value for both Breusch-Pagan is 0.0787, which is greater than 0.05. Thus, the Common Effect Model is more appropriate to use than the Random Effect Model.

Classic Assumption

Normality Test

The following are the results of the normality test using the E-views 9 program:



Based on the normality test, it is known that the Jarque-Bera value is 0.995073 and the Jarque-Bera probability value is 0.608027 which is greater than 0.05. Thus, the residuals are normally distributed

Multicollinearity Test

The following are the results of the multicollinearity test using the E-views 9 program:

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	684.7982	1898.698	NA
TENS	9.555594	44.71130	2.258005
TSOS	0.727561	79.13413	2.272096
TGS	289.9683	2511.999	2.035692
TESG	1.327285	117.1455	2.116469

Table 5.
LM Test Results

Figure 2.
Normality Test Results

Table 6.
Multicollinearity Tes Results

Based on the multicollinearity test, it is known that the Centered VIF value of all independent variables, namely ENS, SOS, GS, and ESG, shows less than 10. Thus, there is no multicollinearity in a regression model.

Heteroscedasticity Test

The following are the results of the heteroscedasticity test using the E-views 9 program:

Table 7.
Heteroscedasticity Test Results

Heteroskedasticity Test: Glejser			
F-statistic	1.101335	Prob. F(9,55)	0.3773
Obs*R-squared	9.925448	Prob. Chi-Square(9)	0.3566
Scaled explained SS	9.227145	Prob. Chi-Square(9)	0.4166

Based on the heteroscedasticity test, it is known that the chi-square probability value is 0.4166, which is greater than 0.05. Thus, there is no heteroscedasticity in a regression model.

Panel Data Regression

Analysis F Test

The following are the results of the F test using the E-views 9 program:

Table 8.
Result of The Model F Test

F-statistic	381.1280
Prob(F-statistic)	0.000000

t Test

The following are the results of the t test using the E-views 9 program:

Table 9.
Result of The t Model Tst

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-39.24132	9.273578	-4.231519	0.0001
ENS	-0.083590	0.076377	-1.094442	0.2785
SOS	0.251507	0.111960	2.246392	0.0287
GS	0.542316	0.237104	2.287255	0.0261
ESG	0.527257	0.228091	2.311609	0.0246

Coefficient of Determination

The following are the results of the coefficient of determination test using the E-views 9 program:

Table 10.
Coefficient of Determinant Test Results

R-squared	0.984219
Adjusted R-squared	0.981636

Based on Table 9, it can be seen that the R-squared value is 0.984219. This shows that the independent and moderating variables can explain variations in financial performance by 98.4%, while the remaining 1.6% is explained by other variables outside this research model.

Discussions

Hypothesis 1, shows that ENS has a coefficient value of -0.083590 with a significance value greater than 0.05 , which is 0.2785 . The results of this test state that environmental performance has a negative and insignificant effect on the company's financial performance. Thus, Hypothesis 1 is rejected. The results of this study indicate that the direction of the coefficient is negative, indicating that environmental performance can have an unfavorable effect on the company's financial performance which is proxied by ROA. This result may occur because companies with environmental performance disclosure practices will incur higher costs followed by higher prices (Alareeni & Hamdan, 2020). In addition, it is also possible for this to occur as a result of environmental damage caused by irresponsible company activities. Meanwhile, positive environmental performance will be able to spur increased sales because consumers want environmentally friendly products. Companies that are consistent with environmental responsibility tend to have external benefits such as getting a good image from potential investors (D.R. Hansen & M/M. Mowen, 2018). This study is in line with the results of research conducted by (Alareeni & Hamdan, 2020).

Hypothesis 2, shows that SOS has a coefficient value of 0.251507 with a significance value less than 0.05 , namely 0.0287 . The results of this test state that social performance has a positive and significant effect on the company's financial performance. Thus, Hypothesis 2 is accepted. Obtaining positive results on social performance indicates that the disclosure of social performance is able to/Can give a good influence on the company's financial performance. This is in accordance with research conducted by Velte (2019) that successful CSR activities will result in better corporate reputation and social performance. In addition, the disclosure of social performance by the company is able to encourage better financial performance of the company.

Hypothesis 3, shows that GS has a coefficient value of 0.542316 with a significance value less than 0.05 , namely 0.0261 . The results of this test state that the performance of governance has a positive and significant effect on the company's financial performance. Thus, Hypothesis 3 is accepted. Governance disclosures that have a positive effect on financial performance can improve asset efficiency (ROA). Effendi (2005) states that the existence of an audit committee is very important in improving financial performance, especially in controlling aspects. This is because the larger the size of the audit committee, the more effective its role in controlling or controlling and monitoring top management will be. The existence of an effective audit committee is one aspect of a good corporate governance mechanism (Sitanggang & Ratmono, 2019). The implementation of good corporate governance is needed to anticipate risks, both financial and company reputation as well as protect stakeholders, improve compliance and maintain generally accepted ethical values (Pratiwi et al., 2018). These results support the research conducted by (Sitanggang & Ratmono, 2019).

Hypothesis 4, shows that ESG has a coefficient value of 0.527257 with a significance value less than 0.05 , namely 0.0246 . The results of this test state that ESG performance has a positive and significant effect on the company's financial performance. Thus, Hypothesis 4 is accepted. This result is in line with the stakeholder theory where the theory assumes that the existence of these stakeholders has an important effect on the sustainability of the company's operations through the support and trust that has been given and is able to increase the level of the company's reputation so that superior performance is expected to be achieved (Safriani, M. N dan Utomo, 2020). In addition, the results of this study are also in line with the theory of legitimacy where one way to obtain strong legitimacy from the public is to provide non-financial information. The information disclosed by the company will be able to invite support and trust from the public and stakeholders through trust in the use of company products or through the inclusion of working capital in the form of assets which will certainly improve the company's operations so that it is expected that the rate of return on company assets used to generate company profits will increase. The results of this study support research conducted by Velte (2019) and Buallay (2019).

CONCLUSIONS

The hypotheses in this research are aimed at figuring out both their significant and insignificant effect. Results of testing for all hypotheses are given as follow:

1. Testing on Hypothesis 1 shows that environmental performance has a negative and insignificant effect on the company's financial performance. These results are shown through the negative regression coefficient value of -0.083590 with a significance value of 0.2785 where the value is greater than the 5% significance value.
2. Testing on Hypothesis 2 shows that social performance has a positive and significant effect on the company's financial performance. These results are shown through the positive regression coefficient value of 0.251507 with a significance value of 0.0287 where the value is smaller than the 5% significance value.
3. Testing on Hypothesis 3 shows that governance performance has a positive and significant effect on the company's financial performance. These results are shown through a positive regression coefficient value of 0.542316 with a significance value of 0.0261 where the value is smaller than the 5% significance value.
4. Testing on Hypothesis 4 shows that ESG performance has a positive and significant effect on the company's financial performance. These results are shown through a positive regression coefficient value of 0.527257 with a significance value of 0.0246 where the value is smaller than the 5% significance value.

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