CHAPTER I

INTRODUCTION

1.1 Research Background

The purpose of establishing a firm are to inseparable from generating profits or adding value to the company. In measuring efficiency and effectiveness can be measured using financial performance. Several variables alter the firm's financial performance, particularly, capital structure, company size and total asset turnover (Sriwiyanti et al, 2021). Meanwhile, according to Faisal et al (2017) the measurement tool that can be used is to use a number of ratios, particularly Liquidity , Leverage/solvability, Activity, Profitability/Income and Valuation Ratios. With good financial performance, the company can generate maximum profits. Financial performance is an important indicator seen by investors in determining investment decisions. The business's public image is expected to improve as a result of its disclosure of environmental, social, and corporate governance responsibilities. The company's income will eventually increase with increasing levels of reputation and consumer trust in The enterprise in order for it has an impact on capturing loyalty to the company itself (EY, 2013: Putri, 2021). In addition,

The above ESG disclosure score is thought to increase asset return. This statement is also supported by Velte (2017) in Meiliana (2020) which states that Environmental, Social and Governance (ESG) disclosures can also affect a company's financial performance.Each company will issue an annual report. The annual report consists of financial and non-financial reports. Financial statements aim to describe how the efficiency of the corporation. Corporate performance is a measure of a company's state through period as a consequence of operational actions carried out with the resources it possesses (Naufal, 2022). Financial performance, operational performance, as well as market performance are all aspects of the enterprise's accomplishment. In considering investment decisions, financial performance is an important reference that is seen by investors. Performance measurement from a financial point of view is important inassessing the success of a company, whether it has been running according to the expected target or not (Maulida and Dwi, 2020). Companies can find out their financial performance by analyzing financial reports, besides that by analyzing financial statements companies can compare the financial performance of the firm from the year prior to the present year whether the company's financial performance has improved or not (Meiliana, 2022),

The Covid-19 epidemic had an effect on the financial performance of firms listing at the Indonesian stock market. Many companies have experienced a decline in income. Utilizing data from the National statistics Agency (BPS), the Covid-19 epidemic reduced income for 82.85% of businesses. Meanwhile, 14.6% of companies have fixed income. The remaining 2.55% of companies experienced an increase in revenue. Thecompany's declining income level will affect cash flow because the company requires costs for its operational activities. Additionally, a survey conducted by the Ministry of Manpower noted that 88% of companies were affected by the pandemic and were in a state of loss. The decrease in revenue was prompted by a drop in the business's revenue and earnings.

The financial prosperity of a business can be influenced by a variety of things. Financial performance is influenced by capital structure,liquidity, company size and tangible assets (Indah, 2017). Meanwhile, according to Eva (2021) Multiple considerations influence financial performance, including capital structure, firm size and total asset turnover. Capon et al (1990) in Meliana (2022) stated that sales, market share, and capital investment intensity can affect financial performance. Recently, ESG has also been linked to components that might have a bearing on a firm financial performance. Research conducted by Meiliana (2017) shows that disclosure about environmental, social, and governance has a favorable impact on financial efficiency of Indonesian enterprises.

In maintaining the continuity of its business, the company mustbe able to face various challenges that occur. As with competition industry developments and even pandemics. In order to survive and convince investors, companies carry out sustainable practices such as disclosing sustainability reports. Disclosure of this sustainability report can be an aspect in assessing the company's long-term sustainability. These days are often known as ESG-based investments. The investment in question is an investment that does not only pay attention to financialmetrics in making investment decisions but also pays attention to ESG factors as non-financial factors (Meliana, 2022).

ESG, which stands for "environmental, social, and governance," is a novel idea. that can be applied in various industries including the financialindustry. ESG disclosure can be a consideration for investors in makingdecisions. Corporations that care about issues related to society and the environment aspects will give a good image to the community. This positive reactioncan increase stakeholder rconfidence there by increasing the worth of the firm which affects financial performance. Which might help the organization in getting maximum profit.

ESG-based investment in Indonesia has been on the rise. Depending on the Indonesian Stock Exchange's (IDX) information, the number of listedcompanies conducting sustainability reporting is increasing where as of 30 December 2021 there were already 154 listed companies or around 20% of the total stock 'listing' companies that issued and reported sustainability (sustainability reports). Disclosure of this sustainability report is not only usedby global but also domestic investors in assessing the applicationof ESGin companies. The same thing is also shown by the value of assets under management (AUM). In 2014, when it was first launched, there was onlyone ESG mutual fund product. However, over time ESG mutual fund products continue to experience growth. In March 2021, the AUM of ESG mutual funds will reach IDR 2.3 trillion. Until 2021 there are 15 ESG-based mutual fund products in Indonesia. This figure proves that companies are increasingly aware that social and environmental aspects are an importantpart of running their business. Wulf, Niemoller, & Rentzsch, 2014 in Era and Susi (2021) said that currently financial reports are considered insufficient for the needs of shareholders, other additional reports are also needed, such as intellectual reports and sustainability reports. Sustainability reports are considered important because they contain non-financial information that explains economic, social, environmental and governance aspects

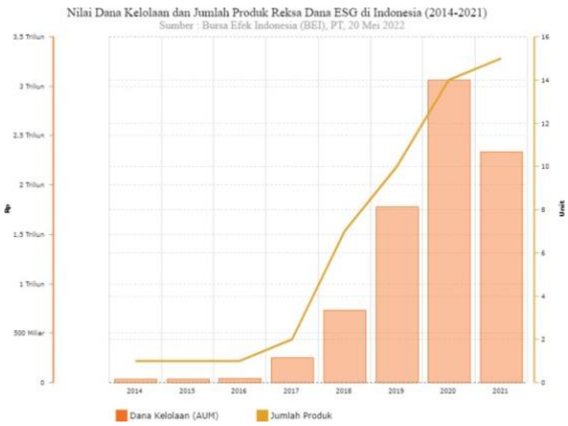

Figure 1.1
Value of Funds Assets Under Management and Number of ESG Mutual Fund Products in Indonesia.

Recently, the term ESG has become a hot issue in global society. Not only investors but many environmental activists and experts are conducting research related to ESG. The ESG issue is also one of the parameters for implementing the SDGs. SDGs 2030 is a sustainable development goal that contains 17 goals and 4 main pillars. The goals of the SDGs include ending poverty, protecting the Earth, increasing thewelfare of people's lives, development that maintains environmental quality progress and growth that ensures fairness, as well as the execution of governance capable of sustaining a rise in the standards of existence. These goals are in line with the principles in the ESG. Therefore, ESG is an indicator for generating globally renowned choices regrading investment.

A study conducted by Naufal Adi's research, ESG Disclosure has a considerable beneficial influence on the firm's financial performance (ROA) in 2022. The outcomes of this study are consistent with the concept of stakeholder theory, which claims that the existence of stakeholders have a bearing on the success of the organization through their backing and faith. This study shows that the three ESG components have an impact in terms of profitability. This issue is in contrast In accordance with Era et Susi's results, 2022 that ESG disclosure has no effect determined by financial efficiency as measured as measured by ROA, or return Tobin's Q score, and revenue growth. Nasruzzaman Naeem, Serkan Çankaya (2021) stated that ESG performance has an important correlation In regard to the financial outcomes of energy and power generation firms.

Many empirical studies in Indonesia only focus on one dimension of ESG and very few have conducted research on all three dimensions. This study will use the ESG disclosure score obtained fromthe company's annual sustainability report. The focus of this investigation is to offer empirical data on the consequences of social responsibility (ESG) disclosure on the financial performance of enterprises in Indonesian. Indonesian is an economically growing nation with extensive exploitation of natural resources. The firms in Indonesia that declare ESG are the focus of this study. This research shows that companies not only carry out operational functions but also provide benefits to their stakeholders. Based on this background, the authors are interested in researching "The Effect of ESG Disclosure on Financial Performance in Companies Listed on the Indonesian Stock Exchange". This study retrieves company data from the 2019- 2021 period. The discoveries of this study can be utilized to help make recommendations for investors by considering the sustainability report.

1.2 Identification Problem

Several issues can be discovered based on the backdrop that has been given, namely:

(1) The number of firms reporting on ESG has increased.

(2) Asset under management and number of ESG mutual fund product increasing.

(3) Investors are starting to consider ESG in making investment decisions.

(4) Many studies have only focused on one component of ESG.

1.3 Limitation

Based on the problem identification description above, The study was carried out at firms listed on the stock market in Indonesia with a limited focus on ESG on Financial Performance in the 2019-2021 period.

1.4 Problem Formulation

The investigation's challenges can be phrased as follows based on the limits of the research questions given above,

(1) How does ESG Disclosure effect the Return On Assets (ROA) of Indonesia Stock Exchange-listed companies?

1.5 Research Objectives

The primary objectives of this study are based on the definition of the problem above :

(1) To investigate the impact of ESG disclosure on the return on assets (ROA) of Indonesian companies listing on the stock exchange of Indonesia

1.6 Research Benefits

This research is expected to be able to give both scientific and practical advantages and applications.

(1) Theoritical, Benefits

As additional knowledge for the accounting literature in terms of the impact of ESG disclosure on firm performance

(2) Practical Benefits

It is a consideration for management to paying close attention to environmental, social, and governance issues can affect company performance. And as a reference for assessing ESG so that (prospective) investors can use it as an indication that the company has a more competitive advantage.