# CHAPTER I

# INTRODUCTION

## A. Background

The multitude influencing factors makes Company Financial Performance (CFP) as one of the crucial assessments for a company, including how a company's Company Social Responsibility (CSR) treats its Environment, Social, and Governance (ESG) (Raza et al., 2012). Various scenarios that have occurred to companies neglecting such matters are not few. Published by CNBC news, PT Gold Mining Sumbawa was sued in 2023 by the community for marine pollution caused by the sinking of a barge carrying nickel ore requiring PT GMS to pay compensation amounting to 1.8 trillion rupiah. Another case involves a coal company attempting to evade Indonesian taxes to maximize the company's profits, which amount to trillions of rupiah. There are also some cases from Kompas, involving  many fisherman who lose their job due to environmental change caused by reckless mining, inappropriate funding to companies violating human rights and companies with no legal support that are allowed to mine. Thus, the policies of a company regarding environmental, social, and corporate governance aspects are the key to avoiding recurring incidents. The impacts that companies face range from fines due to environmental destruction, employee strikes, demonstrations from the public, various lawsuits, to an exposure of the company's poor treatment of the environment, social, and governance issues on the internet. Covering up and resolving these issues require considerable costs and can have serious impacts on the financial performance of a company.

The events that unfolded seemed to awaken all stakeholders involved, such as investors, customers, suppliers, employees, and the government to the importance of developing and implementing ESG (Environmental, Social, and Governance) practices (Grisales & Caracuel, 2021). Thus, forcing the CSR committee to disclose their sustainability report of ESG implementation and investor to be socially aware of their investment decision (Velte, 2017).

Despite the UN's attempt to make ESG-related matters one of their SDG goals in 2030, many CSR committees still don’t show any concern about ESG-related matters in their respective companies (Romano et al., 2020), which leads to uncontrollable risk that may occur during companies practice (Zahroh & Hersugondo, 2021) specifically in the energy and mining companies in Indonesia.

Therefore, Sri Kehati (2009) and IDX (2020) released an index of implementation of ESG by companies, pressuring CSR committees to make an effort to restore and improve their image and ESG management or else they will suffer an enormous effect on their Company's Financial Performance, immediate or later. As stated in Qs Ar Rum : 41

ظَهَرَ الْفَسَادُ فِى الْبَرِّ وَالْبَحْرِ بِمَا كَسَبَتْ اَيْدِى النَّاسِ لِيُذِيْقَهُمْ بَعْضَ الَّذِيْ عَمِلُوْا لَعَلَّهُمْ يَرْجِعُوْن

(٤١ : الرّوم )

“Corruption has appeared throughout the land and sea by [reason of] what the hands of people have earned so He [i.e., Allah] may let them taste part of [the consequence of] what they have done that perhaps they will return [to righteousness]”.

Public interest related to CSR and the treatment of ESG will continue to increase in the future (Turker, 2009). In line with that, Velte (2019) states business is required to publish their information related to ESG activity to the public in order to increase trust from the public. Value and motivation will also be forced to change from short-term shareholders to more sustainable management that, in the end, will lead to successful management as well as increasing the trust of stakeholders.

The majority of previous studies show a positive relationship between ESG and company financial performance, based on a survey on research conducted by Friede et al., (2015). The research from Friede et al., (2015) uncovered the relationship between ESG as a single entity and company financial performance which resulted at positive average when analyzed using variuous approaches such as various region and asset classes. Friede et al (2015) also stated that the study with portfolio ESG and nonportfolio ESG will lead to different levels of correlations and significance because of following reasons : (1) overlapping market and non-market factors tend to blur the ESG value, (2) the method of include ESG screened funds, and (3) only portfolio studies that include other costs such as performance fees and trading costs.

Despite that, Makni et al., (2009) found a negative relationship between ESG and CFP. Trade-off hypothesis and negative synergy hypothesis used by Makni et al., (2009) found that higher ESG will lead to lower Company Financial Performance, thus reduces shareholder wealth and limits socially responsible investment. The subject of this research is a Canadian company that is in moderate size and still young in terms its maturity. The research results would differ if the subjects under study were large corporations with long-term financial objectives (Makni, 2009). Nollet (2015) found the relationship between ESG and CFP is insignificant. Those factors were involving accounting-based financial factor and a specific threshold in overcoming issues. Other than that, the relationship remain insignificant whatever the direction is.

The results of research related to ESG and CFP are so varied and context-dependent. Arayssi et al., (2016) tried a different approach when analyzing ESG – CFP relationship. Thus, he found women on the Board of CSR affected the ESG of the company and in the end increased CFP. The research focused on the participation of women on CSR board directors who handle the ESG of a company. The researcher also said that women can affect the company"s morality and may or may not increase the company's financial performance.

So far, definitive conclusions regarding the relationship between ESG and CFP remain equivocal. Research exploring alternative methods must be done to reach definitive conclusions (Margolis & Aldrich, 2001). Depending on how ESG is defined, researchers may obtain different results (Alareeni & Hamdan, 2020). in other words, researchers need to define ESG down to its roots. Thus, this journal will focus on disaggregating the ESG components into Environment (E), Social (S), and Governance (G).

The environmental aspect refers to a company's actions towards the environment, including waste reduction, environmental restoration, and other environmental conservation efforts (Almeyda & Darmansyah, 2019). Velte (2017) stated that the environmental aspect has a positive but insignificant relationship with CFP, unlike A. Ghazali et al. (2020) who mentions that the lack of a significant relationship between the environmental aspect and CFP is due to the inadequacy of reporting on environmental actions taken. Nozawa et al., (2017) mentioned the absence of a significant relationship between the environmental aspect and CFP; however, there is a significant positive relationship with firm efficiency. Hence, the need for a separate assessment for this variable. Almeyda & Darmansyah, (2019) stated that there is a random relationship depending on the variable used to represent CFP. The relationship between the environmental aspect and CFP is complex, with the possibility of a positive relationship, potentially influenced by a distinct assessment of this variable.

The social aspect refers to a company's actions towards the social life around the establishment of the company, including donations, human rights, employee health, and other social activities (Kuzey, 2021). A. Ghazali et al. (2020) mentionsed that the lack of a significant relationship between the social aspect and CFP is due to the social aspect not being able to stand alone in a company. Nozawa et al. (2017) stated a significant positive relationship with CFP. Zahroh (2021) mentioned a positive but less relationship. Meanwhile, Almeyda (2019) stated there is no significant relationship. The relationship between the environmental aspect and CFP is complex, with the possibility of a positive relationship, potentially influenced by distinct assessment of this variable.

The governance aspect refers to how a company manages and controls itself, including anti-corruption actions, business processes and strategies, and company structure. Velte (2017) stated a significant positive relationship with CFP, attributing this to corporate maturity. On the other hand, Ghazali et al., (2020) and Almeyda (2019) mentioned the lack of a significant relationship between the corporate governance aspect and CFP due to the insufficient implementation of a good Corporate Governance Code (CGC). Meanwhile, Nozawa et al., (2017) mentioned the relationship between governance and CFP as a non-negative relationship, as less mature companies have shortcomings in governance reporting compared to mature companies. The relationship between the governance aspect and CFP is complex, with the possibility of a significant positive relationship attributed to corporate maturity. However, the lack of a significant relationship due to insufficient implementation of a good Corporate Governance Code (CGC) and the non-negative relationship observed in less mature companies compared to mature companies suggests a nuanced understanding of this relationship.

The inconsistent result shown by previous results opened up new research opportunities in the same field in different approaches and different fields. This study is a modification of the research conducted by Kuzey et al., (2021), utilizing the CSR committee performance as the independent variable against CFP as the dependent variable which obtained positive results. The CSR committee in Kuzey’s (2021) article served as the committee responsible for formulating ESG policies. Kuzey (2021) also suggested adding a moderator variable for further research. Considering this, the study broke down ESG into its components. Women on board were chosen as the moderator variable because theoretically, they can strengthen the relationship between E-CFP, S-CFP, and G-CFP ((Setiani, 2023); (Romano et al., 2020); (Zeng & Jiang, 2023)). Thus, this study is entitled “The Influence Of Environment, Social, And Governance to Company Financial Performance Using Women On Board As Moderating Effect”

**B. Research Limitation**

This research will focused on energy and mining companies that are included in the ESG index provided by the Indonesia Stock Exchange (IDX) in 2021-2023.

**C. Research Problem**

Based on the afformentioned background, the problem statement can be formulated as follows:

1. Does the environment area of ESG have a impact on company financial performance?
2. Does the social area of ESG have a impact on company financial performance?
3. Does the governance area of ESG have a impact on financial performance?
4. Does ESG as a whole have a impact on financial performance?
5. Does the Women on Boards moderate the relationship between the environment area of ESG and the company financial performance?

6. Does the Women on Boards moderate the relationship between the social area of ESG and the company financial performance?
7. Does the Women on Boards moderate the relationship between the governance area of ESG and the company financial performance?
8. Does the Women on Boards moderate the relationship between ESG and the company financial performance?

**D. Research purposes**

The purpose of this research is to test and obtain information about:

1. To empirically test the influence of the environment area of ESG on company financial performance.
2. To empirically test the influence of the social area of ESG on company financial performance.
3. To empirically test the influence of the Governance area of ESG on company financial performance.
4. To empirically test the influence of ESG on company financial performance.
5. To empirically test the moderating influence of the Women on Boards on the relationship the between the environment area of ESG and the Company financial performance.
6. To empirically test the moderating influence of the Women on Boards on the relationship between the social area of ESG and Company financial performance.

7. To empirically test the moderating influence of the Women on Boards on the relationship between the governance area of ESG and Company financial performance.
8. To empirically test the moderating influence of the Women on Boards on the relationship ESG and Company financial performance.

## E. Research benefit

The benefits that researchers expect from this research are as follows:

1. **Theoretical Benefits**

   This study examines and produces relationships between variables that are included with an understanding of the basic concepts of variables, research directions, and research frameworks so that they can contribute to the development of science to parties who need this research as a form of support in encouraging minds to be more critical. Additionally, it can be one of the literature studies to see the level of consistency of the Company's components that can affect the quality of financial statements and Company value.

2. **Practical Benefit**

   a. For company

      This research can provide valuable insights and benefits to companies, helping them make more informed decisions, develop strategic plans, gain competitive advantage, attract investors, manage risks, and enhance their corporate reputation.

b. For investor

This research can give information about investment decisions needed, supporting companies with strong long-term performance potential, aligning investments with values, gaining a competitive advantage, attracting capital, and promoting transparency and accountability in the companies they invest in

c. For future research

It is anticipated that this research will also yield fresh information and serve as a reference for future studies on the impact of the Company's components on financial performance and Company value.