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The Role of Company Performance in Determine Effect of ESGD on Risk of Financial Distress

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A B S T R A C T

The study aims to determine the roles of company performance in assessing the effect of ESGD on the occurrence of financial distress. This study uses the dependent variable of financial distress as measured by the Altman Z-score method, the independent variable uses ESGD whose scores are obtained from the website of the BGK Foundation, and the intervening variable of company performance as measured by the stock price. The samples used in this study were all non-financial and banking companies listed on the IDX in 2018-2021 and reporting the value of ESGD on the BGK Foundation website. The tool used in this research is path analysis. The results of this study indicate that company performance and ESGD do not affect financial distress. ESGD has a negative effect on company performance. In addition, company performance also cannot mediate the effect of ESGD on financial distress.

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1. INTRODUCTION

Financial Distress is a condition of financial difficulty experienced by a company. Financial Distress is very important for companies to know early so that the company can take action that can overcome or minimize the impact of Financial Distress which can ultimately result in bankruptcy. As happened with a large drinking water company in Indonesia with the ALTO brand produced by PT Tri Banyan Tirta, Tbk. This company officially closed its factory in Cidahu Sukabumi on November 20, 2022. This factory was forced to close due to the impact of Covid-19 and the global economic crisis. Apart from that, the company also objects to the minimum wage regulations by the Indonesian Ministry of Manpower which have been issued in Permenaker number 18 of 2022 concerning minimum wages in 2023 (Salam, 2022).

This incident can occur because the company is negligent in noticing condition environmental, social, and governance company or the current one, this is more known with ESG (Environmental, Social and Governance). ESG is a set of standards that refers to three main criteria in measuring sustainability aspects, namely environmental, social, and governance. A company is said to have fulfilled environmental aspects when the company has considered the impact of its business operations on the environment in which the company operates. The social aspect is said to have been fulfilled when the company considers the company's relationship or reputation with its stakeholders. The governance aspect can also be fulfilled when the company considers the principles of corporate governance in the company's operational activities (IDX-ESG, 2023). Reporting on this company's ESG activities is contained in OJK regulation number 51/POJK.03/2017 concerning the implementation of sustainable finance for financial service institutions, issuers, and public companies as well as the sustainable finance roadmap phase II for 2021-2025.

Publication of reports related to ESG activities by companies to the public shows that the company is committed to carrying out each of its activities by paying attention to environmental, social, and governance aspects. The more activities a company undertakes related to ESG aspects are disclosed, the better the stakeholder's view of the company will be. This is because stakeholders are considered to obey the rules and also care about the environment, society, and governance in carrying out all their activities. This increase in stakeholders' trust also automatically has an impact on the company's good name which in the end can attract investors to invest their funds so that the company can continue to carry out the company's operational activities. Therefore, the company will earn regular income or profits which can later be turned back to fund the company's needs. In this way, the company will have good performance so that there is little chance of financial distress occurring.

This is also in line with the signal theory of Spence (1976) which shows that ESG disclosure is a positive signal for investors to invest their funds in companies so that they can improve company performance. Apart from that, this is also supported by the legitimacy theory which states that ESG disclosure is a form of company management's responsibility toward the public in compliance with existing regulations issued by the government. This is supported by research from Zahro & Hersugondo (2021); Husada & Handayani (2021); Ahmad et al. (2021); Nugroho & Hersugondo (2022); Gholami et al. (2022);

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Rimawati & Darsono (2017); Chiaramonte et al. (2022); Cahyoputro & Hadiprajitno (2022); Citterio & King (2023); and Oktarina (2018b). Based on theory and previous research, the hypothesis that can be formed is:

H1: ESGD influences company performance.

H3: ESGD influences financial distress.

High company performance shows that the company has sufficient funds to carry out company activity, especially operational activity. Thus, high performance indicates that the company is not in a state of financial distress. This is also supported by the agency theory which states that the agent must carry out orders from the principal even though basically agent carries out orders solely to obtain bonuses for themselves. However, this does not become an obstacle for the principal to continue to give orders related to achieving company performance, which the agent must continue to carry out. In this way, the company will continue to make a profit and will still be able to carry out the company's operational activities so that the company will not experience financial distress. This is supported by research from (Rachmawati & Retnani, (2020); Syuhada et al. (2020); Rinofah et al. (2022); Oktarina (2018b); Oktarina (2017); And Oktarina (2019). Based on theory and previous research, the hypothesis that can be formed is:

H2: Company performance influences financial distress.

ESG (Environmental, Social, and Governance) disclosure is a form of corporate responsibility towards the environmental, social, and governance in carrying out company activities. This ESG disclosure improves the company's good image in society, especially investors. Investors assume that a company that discloses ESG implies that the company has been well managed by management so investors are interested in investing their funds in the company. The more investors invest their funds in a company, the higher the demand for company shares. Thus, following the law of demand, the higher the demand, the higher the price, which can be interpreted as the more investors make requests to purchase shares, the higher the company's share price, which in this research is a proxy for company performance. High company performance shows that the company has sufficient funds to carry out company activity, especially operational activity. Thus, high performance indicated that the company is not in a state of financial distress.

This is supported by signal theory which implies that ESGD is a good signal for companies that will improve company performance. Thus, company performance is also a good signal for the company because increasing company performance indicates that the company is in good financial condition. If the company's financial condition is good and maintained, the company will experience minimal financial distress. This is also supported by research results from Setiorini et al. (2022) which state that company performance can be used as a mediating variable on the effect of ESGD on financial distress. Based on theory and previous research, the hypotheses that can be formed is:

H4: Company performance can strengthen the influence of ESGD on the occurrence of financial distress.

2. RESEARCH METHODOLOGY

This research uses secondary data. Secondary data is data obtained indirectly from the research object. Data from this research was obtained using documentation from several websites, books, and articles. The websites used are the IDX website, the BGK

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Foundation website, and the company's official website. Data obtained from the IDX website and the company's official website is data related to the number of registered companies and company financial reports, while data obtained from the BGK Foundation website is data related to the percentage of ESG disclosure.

The dependent variable in this research is financial distress. In this study, financial distress was measured using the Altman z-score model with the following formula:

Z-Score = 0.717X1 + 0.847X2 + 3.107X3 + 0.42X4 + 0.998X5

Where:

X1 = Working Capital/Total Assets

X2 = Retained Earnings/Total Assets

X3 = Profit Before Interest and Tax/Total Assets

X4 = Market Value of Equity/Total Debt

X5 = Sales/Total Assets

The independent variable in this research is ESG disclosure. ESG disclosure stands for Environmental, Social, and Governance disclosure in the company's sustainability report regarding activities that have been carried out by the company which includes the environment, social, and governance. The value of ESG disclosure can be seen on the BGK Foundation website where the website contains the percentage of ESG disclosures made by each company each year both in terms of environment, social, governance, and overall disclosure. The intervening variable in this research is company performance. Company performance in this study was measured using closing share price at the end of the year, namely December 31 each year.

The population used in this research is all companies listed on the non-financial and banking IDX in 2018-2021. The sampling technique in this research is purposive sampling with the following criteria:

1. Non-financial and banking companies that disclosed ESG at the BGK Foundation in 2018-2021 consecutively
2. Non-financial and banking companies that have financial reports presented in Rupiah

This research uses a path analysis model to examine the relationship between ESGD and financial distress and the relationship between ESGD and financial distress mediated by company performance. Before path analysis was carried out, descriptive statistical tests were carried out as well as the classic assumption of normality (Ghozali, 2016).

Descriptive statistical analysis was carried out to see the distribution of data from existing variables starting from data related to minimum values, maximum values, average values, and also standard deviation values. With this descriptive statistical analysis, you can also see whether the data is heterogeneous or homogeneous. If the standard deviation value is smaller than the average value then the data is homogeneous, and conversely, if the standard deviation value is greater than the average value then the data is heterogeneous.

The classic assumption test carried out in this research is the normality test. The normality test is used to ensure that the residual data is normally distributed. This normality test was carried out using the Kolmogorov Smirnov test with the criteria that the residual data is normally distributed when the significance value is more than equal to 0.05 and the residual data is not normally distributed when the significance value is less than 0.05. Path analysis is carried out to determine whether the hypothesis is accepted or

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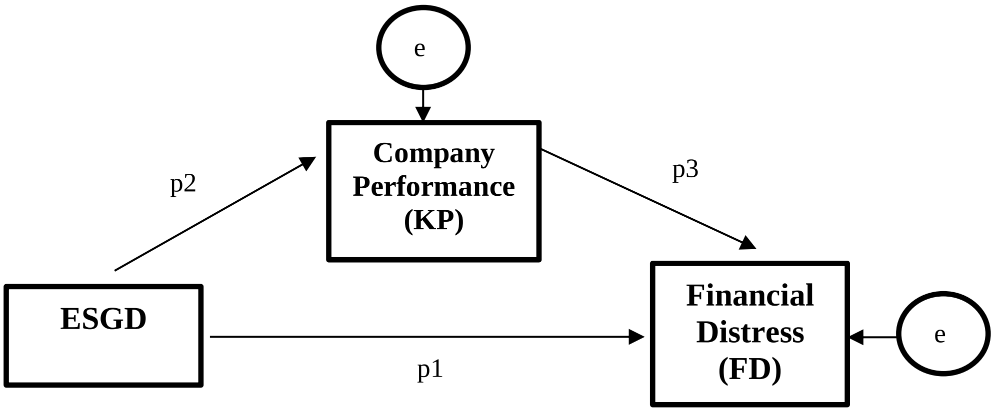
rejected. The following are the steps in path analysis:

a. Path diagram development

The aim of developing a path diagram is to describe the relationship between the variables to be tested. Based on the theoretical relationship between variables, a model can be created in the form of a path diagram in Figure 1 below:



Source: Data processed

Figure 1. Path Diagram

Figure 1 shows that each p-value describes a path and path coefficient. The p1 value describes the direct relationship between ESGD and financial distress. The p2 and p3 values show an indirect relationship between ESGD and financial distress which is mediated by company performance. The total influence of the relationship between ESGD on financial distress can be calculated as follows:

ESGD to financial distress	= p1
ESGD to KP to FD	= p2 x p3
Total	= p1+(p2xp3)

The p-value is a path coefficient whose value is obtained from the standardized value of the regression coefficient. The e value in Figure 1 describes the error value of two equations that show direct and indirect effects which can be calculated using the following formula:

$$e = \sqrt{(1 - R^2)}$$

b. Convert path diagrams into equations

Based on Figure 1 of the path diagram that has been created, two equations can be created to describe the direct and indirect effects. The following two equations are used:

$KP = \alpha + p2ESGD + e1$................................ First equation

$FD = \alpha + p1ESGD + p3\,KP + e2$ .... Second equation

Information:

KP : Company Performance
FD : Financial Distress
ESGD : ESG Disclosure
α : Constant
p1-3 : Coefficient
e1-2 : Error

c. Sobel test

This analysis was carried out to assess whether company performance can be used as a mediating variable by calculating the standard error of the indirect effect coefficient to determine the statistical t value that will be compared with the t table value. If the t

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statistical value is greater than the t table with a significance level of 0.05 then it can be said that the mediation coefficient is significant, which means there is a mediation effect, and vice versa if the t statistical value is smaller than the t table with a significance level of 0.05 then it can be said that the t statistical value is greater than the t table with a significance level of 0.05 then it can be said that the coefficient mediation is not significant, which means there is no mediation effect.

3. RESULTS AND DISCUSSION

Based on the sample criteria that have been created, of the 19 non-financial and banking companies registered on the IDX and disclosing ESG at the BGK Foundation in 2018-2021, 6 companies do not report financial reports in Rupiah, so the total number of companies that can be used is obtained. The sample is 13 companies for 4 consecutive years. Thus, the total sample data used in the research was 52 data. The following table 1 shows the selection of research samples:

Table 1. Research Sample

Sample Criteria	Number of Companies	Research Period	Number of Samples
Non-financial and banking companies that disclosed ESG at the BGK Foundation in 2019-2021 consecutively	19	4	76
Non-financial and banking companies that have financial reports presented in currencies other than Rupiah	6	4	24
Total that can be used as a sample	**13**	**4**	**52**

Source: Data processed

Descriptive statistical analysis was carried out for financial distress, company performance, and ESGD variables consisting of minimum value, maximum value, average value, and standard deviation value which were used to see whether the data is homogeneous or heterogeneous. The following table 2 presents the results of descriptive statistical tests.

Table 2. Descriptive Statistics

Variable	Minimum	Maximum	Mean	Std. Deviation
Company performance	IDR.246,-	IDR.19,025,-	IDR.4,459,-	IDR.4,853,-
ESGD	7.36%	66%	28.76%	14.68%
Financial Distress	0.241	4,559	1,791	0.983

Source: Data processed

Based on table 2, shows that company performance, as proxied by share prices, has a minimum value of IDR246,- for the company PT Wijaya Karya Beton Tbk in 2021, while the maximum value is IDR 19,025,- for the company PT Indocement Tunggal Prakarsa Tbk in 2019. The standard deviation of company performance was IDR.4,853,- greater than the average value of company performance of IDR.4,459,- which means that company

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performance data is heterogeneous or the data is more widely distributed. The ESGD variable shows that the minimum value is 7.36% at PT Pembangunan Perumahan (Persero) Tbk in 2018, while the maximum value is 66% at PT Bukit Asam Tbk in 2021. The ESGD standard deviation value is 14.68% smaller than The average ESGD value is 28.76%, which means the data is homogeneous or the data distribution is narrower or uniform. Financial distress data shows a minimum value of 0.241, namely for the company PT Jasa Marga (Persero) Tbk in 2020 where the minimum value is less than 1.23, which means the company is experiencing financial distress in that year. The maximum value on the financial variable distress amounted to 4,559, namely for the company PT Unilever Indonesia Tbk in 2018, where this value was greater than 1.23, which means the company did not experience financial distress in that year. The standard deviation value of financial variables distress is 0.983, which is smaller than the average value of 1.791, which means that the distribution of financial data is small distress or it can be said that the data is homogeneous. Before carrying out path analysis, the data must first meet the normality assumption. The following are the results of the normality tests that have been carried out:

Table 3. Normality Test Result

Information	Mark
Kormogolov-Smirnov Z	1,216
Asymp. Sig. (2-tailed)	0.104

Source: Data processed

Based on the results of the normality test in Table 3, it shows that the significance value is 0.104. This value is greater than the alpha value of 0.05, which means the residual data is normally distributed. In this way, the data can be continued in the next test. The following is table 4 which shows the regression results from the first and second equations from the path analysis:

Table 4. Regression Results for First and Second Equations

Information	Value
First Equation	
β ESGD → p2	-10,413.093
Sig.	0.023
Std. Error	4,436.12
Constant	7,452.943
R-Square	0.099
e1	0.949
Second Equation	
β ESGD → p1	-0.068
Sig.	0.946
Std. Error	1.006
β KP → p3	0.000011
Sig.	0.719
Std. Error	0.000
Constant	1.762
R-Square	0.003
e2	0.998

Source: Data processed

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Based on Table 4, equations one and two can be made as follows:

$KP = 7.452{,}943 - 10.413{,}093\ ESGD + 0{,}949$ ……… First Equation

$FD = 1{,}762 - 0{,}068\ ESGD + 0{,}000011\ KP + 0{,}998$ ……… Second Equation

Based on the data in Table 4, shows that the first equation produces an ESGD beta of -10,413.093 with a significance level of 0.023, meaning that ESGD has a negative effect on company performance, while the results of the second equation, ESGD beta is -0.068 with a significance greater than 0.05, which means ESGD has no effect on financial distress. The KP beta value of 0.000011 with a significance greater than 0.05 means that company performance has no effect on financial distress. The magnitude of the mediation effect is determined by multiplying the ESGD beta in the first equation and the KP beta in the second equation which produces a figure of -0.1145. Next, a Sobel test was carried out to determine whether the amount of mediation had a significant effect or not. Sobel test calculations obtained a t-statistical result of -2.347 which is smaller than the t-table with a significance of 0.05, namely 1.96, which means that company performance cannot be used as a mediating variable.

The Effect of ESGD on Company Performance

Based on the test results, it show that ESGD has a negative effect on company performance. This can happen because the ESGD disclosures made show that the company has great focus and attention to the environment, which causes the company to incur quite large costs. The amount of costs incurred by the company comes from none other than the sales proceeds obtained by the company. Thus, the allocation of profits or sales proceeds to ESG activities reduces the rights of shareholders to obtain dividends from company sales proceeds. This is what makes investors less interested in company shares, which results in decreased demand for shares which will gradually reduce the company's share price.

Based on theory, the results of this research contradict signal theory and stakeholder theory which state that ESG disclosure will certainly improve company performance as reflected in the company's share price. This can happen because ESG disclosure should be a positive signal and a form of company responsibility to its investors so that it can attract investor interest which will gradually increase demand for company shares which will also increase the company's share price which is a proxy for company performance.

However, the results of this research are in line with research from Nugroho & Hersugondo (2022) which states that CSR disclosure which is part of ESG in the form of social aspects has a negative influence on company performance. This can happen because the practice of implementing social responsibility in companies incurs a lot of costs which in the end will also reduce the proportion of income earned by the company to be distributed to shareholders because it is used for implementing CSR activities.

The Influence of Company Performance on Financial Distress

Based on the test results, it show that company performance has no effect on financial distress. This can happen because based on existing data, several companies have company performance values that are proxied by share prices above the average value, one of which is the company PT Jasa Marga (Persero) Tbk with a company performance value of IDR.5,175,- which has a z- score value which is a proxy for financial measurement distress is 0.560, which means the company is experiencing financial distress. Apart from that, based on existing data, several companies have company performance values below the average value, having a z-score value greater than 1.23, which means the company is

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not experiencing financial distress. One example is the company PT Total Bangun Persada Tbk which has a company performance value proxied by a share price of IDR.316,- with a z-score of 2.97 above 1.23, which means the company does not experience financial distress even though it has a share as a measure of company performance is smaller than the average value of company performance.

Based on the theory used, the results of this research are contrary to signal theory, agency theory, and stakeholder theory which states that company performance is a positive signal and a form of compliance by company management to carry out orders from shareholders as principals, and is the company's responsibility to its shareholders is one of the company's stakeholders. Thus, high company performance certainly indicates that investor interest in the company is also high so that the company has sufficient reserves or financial assistance to carry out company operations. Therefore, the company will be far from financial distress.

However, the results of this study are in line with research from Syuhada et al. (2020) which states that company performance, which is proxied by the activity ratio, has no effect on the occurrence of financial distress. This is because the high activity ratio indicates that the sales costs incurred by the company are high so that the proceeds from sales are not immediately used for investment or savings but can be used up to finance the company's sales so that gradually the company experiences financial distress.

The Effect of ESGD on Financial Distress

Based on the test results, shows that ESGD has no effect on financial distress. This can happen because based on existing data, several companies have ESG disclosure values above the average value, but are still experiencing financial distress. For example, the company PT Wijaya Karya (Persero) Tbk has an ESG disclosure of 62%, but the z-score value is only 0.655, smaller than 1.23, which means the company is experiencing financial distress. Apart from that, several companies that have ESG disclosure values below the average value but are not experiencing financial distress. For example, the company PT Astra Agro Lestari Tbk which has an ESG disclosure value of 9% but has a z-score of 1.284 is greater than 1.23, which means the company is not experiencing financial distress.

Based on the theory used, the results of this research contradict the stakeholder theory and legitimacy theory which state that ESG disclosure affects financial distress. This can happen because wider ESG disclosure is a demand from stakeholders and is also an obligation issued by the government to obtain a good image in the society or the public. This will certainly attract investor interest so that investors invest their funds in the company. In this way, the company will still have enough funds to use in its operations so that the company is less likely to experience financial distress.

However, the results of this research are in line with research from Cahyoputro & Hadiprajitno (2022) which states that CSR disclosure which is part of ESG in the form of governance and social aspects does not affect financial distress. This can happen because company resources are used for social and governance issues that are not focused on the main stakeholders, do not create value for shareholders, and do not provide profits for the company. This is what makes the company gradually have difficulty with funds to carry out its operational activities so that sales are not optimal and the company will experience financial distress.

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The Effect of ESGD on Financial Distress with Company Performance as an Intervening Variable

Based on the test results, it shows that company performance as proxied by share prices cannot be used as a mediator between ESGD and financial distress. This is because based on research data shows that several companies have high ESG disclosure values and company performance, but the companies are indicated to be experiencing financial distress. Apart from that, several companies have low ESG disclosure scores and company performance but are not indicated to be experiencing financial distress. For example, the company PT Jasa Marga (Persero) Tbk which has an ESG disclosure value of 33% and company performance as proxied by a share price of IDR 5,175 is above the average value but has a z-score of 0.56. below 1.23, which means the company is experiencing financial distress. This shows that the amount of ESG disclosure plus the high performance of the company, which in this case is seen from the size of the share price, does not necessarily mean that the company is not experiencing financial distress. Apart from that, there is also the company PT Japfa Compfeed Indonesia, Tbk which has an ESG disclosure value of 13.28% and also a share price of IDR.2,150,- where this value is below the average value but has a z-score value of more than 1.23, which is equal to 2,442, which means the company is not experiencing financial distress. This shows that it is not certain that companies that have ESG disclosure values plus low share prices will experience financial distress.

Based on the theory used, the results of this research contradict the signal theory which implies that ESGD is a good signal for the company. Extensive disclosure will make investors interested in the company because they feel confident that the company has carried out company activities while still paying attention to social and environmental aspects. Interestingly, these investors have increased demand for company shares. This is what will cause the company's share price to increase as well. With a high share price, the company can easily obtain funds from investors. In this way, the company will be able to manage company activities, especially company operational activities, so that the company is far from financial distress.

4. CONCLUSION

Based on the results of the analysis and discussion, it can be concluded that company performance and ESG disclosure do not affect financial distress. Apart from that, company performance also cannot mediate the influence of ESG on financial distress. Only ESG disclosure has a negative influence on company performance. This is because the company's focus on implementing social and environmental activities causes the company to incur a lot of costs which drain the company's sales proceeds so that the company finds it difficult to distribute sales proceeds to shareholders so that investors become disinterested and the company's shares will experience a price decline.

The researcher realizes that there are still weaknesses that are limitations to this research, namely the R-square value in both the first and second equations has very small values, 0.099 and 0.003, which means that the variables in the research are only able to influence 9.9% and also only 0.3%. Based on the existing limitations, the researcher suggests that future researchers can conduct research with a larger number of sample data

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from both companies and years used because a large number of samples can increase the R-square value so that it can prove that the variables used can have a significant influence.

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