The Impact of Environment Social Governance (ESG) Performance on Stock Returns in Indonesian Companies

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ABSTRACT

The aim of this research is to examine the performance of Environmental, Social, and Governance (ESG) on the stock return value of companies in Indonesia. This study falls under the third step of measurement, which is the proof-of-concept of important functions and/or characteristics through analytical and experimental methods. The research methodology uses a quantitative approach with a combined time series and cross-sectional data (panel data). Data collection is done using secondary data, where data is gathered from existing sources. In this study, the data is obtained from Bloomberg. The population for this research comprises companies listed on the Indonesian Stock Exchange with available ESG disclosure scores on Bloomberg for the period of 2017-2021. Based on the hypothesis test results, it is found that ESG performance and social performance have a positive effect on stock returns. However, the performance of governance and the environment, has no effect on stock returns.

Keywords: ESG Performance, Environmental, Social, Governance, Stock Return

INTRODUCTION

Initially, most sustainability definitions focused on the impact of business operations on the natural environment, such as environmental performance, environmental strategies, ecological sustainability, and maintaining centrism (Klassen and McLaughlin 1996; Russo 2003; Shrivastava 1995; Gladwin, Krause, and Kennelly 1995). Later, the scope of sustainability reporting was extended to include the impact of corporate operations on the social, economic, and environmental systems.

Bansal (2005) Stated that Sustainability has become a major concern, and investors should consider ESG factors when building their portfolios to reduce any potential risks to the environment, particularly climate change, social risks, particularly human rights, and governance risks. ESG investment models have now become a standard approach worldwide and are reflected in metrics, ratings, guidelines, and ESG regulations.

The term Environmental, Social, and Governance (ESG) first emerged and was coined in the report “Who Cares Wins: Connecting Financial Markets to a Changing World” by the UN Global Compact in 2004 (Global Compact, 2004). The report’s objectives included integrating ESG standards into the financial industry and offering suggestions and guidelines for incorporating ESG-related risks and opportunities into investment research and financial markets. In other words, the report recommended further integration of environmental, social, and governance issues into financial analysis, asset management, and securities markets.

Almeyda and Darmansya (2019) Explained that the global financial market currently considers ESG factors as one of the tools for decision-making processes. Because institutional and individual investors understand that ESG serves the opportunities and risks that a company faces, they value a company's ESG actions. Research findings Coleman, Maheswaran, and Pinder (2010) Indicate that the decision of whether to invest in a firm is now made by investors using non-financial information, such as ESG criteria. Therefore, in addition to considering financial performance, investors also take into account CSR activities, particularly in terms of ESG elements.

When investors make investments in a company, they naturally expect higher returns on their invested funds and the desired returns typically come in the form of yield income and capital gains (Kusuma and Topowijono 2012; Utami and Gumanti 2014). While investors used to focus on financial statements in their decision-making process, recent studies (Chen, Dong, and Lin 2020; Chen and Xie 2022) Suggest that social preferences and social signaling play a more significant role in explaining the decisions of socially responsible investment (SRI) investors than financial motives. (Li, Feng, and Pan 2022) Further emphasize that investors need to consider ESG factors in their investment decisions to enhance investment outcomes during challenging times. Finally, policymakers should promote the use of ESG principles and urge businesses to disclose information about their ESG performance, which is essential for the sustainability of the economy.

Several previous studies have indicated that the market responds positively to positive ESG news. In this regard, ESG investments can improve portfolio performance, reduce portfolio risks, and increase stock returns (Serafeim and Yoon 2022; Li et al. 2022). Moreover, ESG practices can be used as instruments for risk management to increase stock price resilience, especially in turbulent times. Research findings (Luo 2022) suggest that indicating that the impact of ESG on stock returns is tied to liquidity, ESG is only important for stocks with low liquidity and is not meaningful for stocks with high liquidity. ESG consequently affects how investors make decisions in a practical way.

The ESG Performance to Stock Returns

Environmental, social, and governance is a corporate standard that encompasses three concepts: environmental, social, and corporate governance (Global Compact, 2004). According to (Qodary and Tambun 2021), companies that implement ESG in their operational activities can attract investors because they are believed to provide a mutually beneficial relationship between investment portfolios and the environment and society. In a study conducted by (Albuquerque et al. 2020), it was found that stocks of companies with higher rankings in environmental and social (ES) factors were able to withstand the economic crisis caused by the Covid-19 pandemic.

H1 = ESG performance has a positive influence on stock returns.

The Environmental Performance to Stock Returns

The definition of sustainability highlights how company operations affect the environment. Utami (2015) ; Syafrullah and Muharam (2017) Explain if a company achieves a good score in terms of environmental concern, its sustainability will also be good because the sustainability of a company depends not only on improving financial performance but also on the attention given to all stakeholders, including the environment. According to Almeyda and Darmansya (2019) Research, there is a correlation between environmental performance and stock prices that is favorable and that affects stock returns' size.

H2 = Environmental performance has a positive influence on stock returns.

The Social Performance on Stock Returns

Good social performance encourages companies to engage with communities and take responsibility for maintaining value for investors and society. Triyani, Setyahuni, and Makwuna (2021) State that in order to protect and enhance value, companies take a series of steps to mitigate potential risks. The better the social performance and the higher the quality of information disclosed about social performance, the greater the public's trust in the company (Sassen, Hinze, and Hardeck 2016). High public trust enables companies to access resources, particularly capital resources, more easily, which can be reflected in stock price returns.

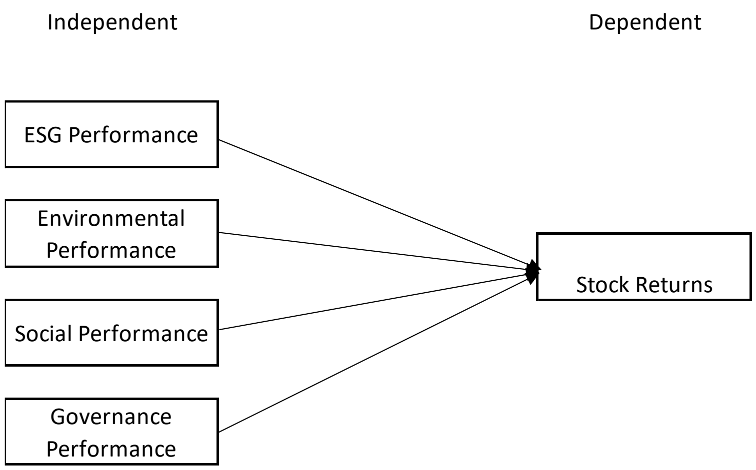
H3 = Social performance has a positive influence on stock returns.

The Governance Performance on Stock Returns

Governance is a crucial element within a company that is established to ensure the effectiveness and efficiency of its business activities (Triyani et al., 2021). Additionally, governance plays a role in controlling both financial and non-financial operational processes. According to Chang, Kim, and Li (2014) corporate governance creates a process that balances the interests of management with stakeholders and ensures a "check and balance" mechanism. The function of governance is to facilitate goal congruence, which means aligning management objectives. The disclosure of information related to governance is an indication that the company is committed to transparency and accountability.

H3 = Social performance has a positive influence on stock returns.

Based on the background and conceptual framework, the following framework can be established



RESEARCH METHOD

Population and Research Sample

The population in this study consists of companies listed on the Indonesia Stock Exchange (BEI) and having an ESG disclosure score on Bloomberg for the period 2017-2021. The sampling technique used in this research is purposive sampling, where samples are selected based on the suitability of their characteristics with predetermined sample criteria to obtain a representative sample. The sample criteria for this study are as follows:

Companies listed on the BEI from 2017 to 2021 and companies having ESG disclosure scores on Bloomberg for consecutive years from 2017 to 2021.

Based on the data on Bloomberg, there are 102 companies that have ESG disclosure scores, but 5 companies do not have consecutive ESG scores. Therefore, a sample of 87 companies is obtained. Based on the observation period of 5 years, a total of 435 data points are obtained.

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Dependent Variable

The dependent variable is the variable that is influenced or affected by the independent variable. The dependent variable used in this study is stock return. Stock return is calculated as follows according to Brigham & Houston (2014):

Ri = (Pt – Pt-1) / Pt-1

Where:

Ri = Stock return

Pt = Stock price at time period t

Pt-1 = Stock price at time period t-1

Independent Variable

The independent variable is the variable that influences or causes changes in the dependent variable (the outcome variable) (Sugiyono 2013). The independent variables used in this study are ESG performance (ranging from 0 to 100), which consists of ESG disclosure score, Environmental disclosure score,Social disclosure score, and Governance disclosure score.

Analysis Method

Descriptive and verificative analysis is the data analysis technique employed in this study. Panel data regression analysis (pooled data) is used for the verificative analysis in this study. Eviews 12 was used to process the data in this investigation.

1. Descriptive Statistical Analysis
2. Panel Data Regression Analysis. Panel data can be estimated using three methods: Ordinary Least Squares (OLS) or Common Effect Model, Fixed Effect Model, and Random Effect Model.
3. Model Selection Method. Chow test, Hausman test, Lagrange Multiplier Test
4. Classical Assumption Tests
5. Hypothesis Testing. Coefficient of Determination (Adjusted R2), Simultaneous F-Test, t-Test (Statistical Test)

RESULT AND DISCUSSION

Result

Table 1. deskriptif test result

	Return	ESG	Environment	Social	Governance
Mean	6.45	43.11	28.13	30.11	73.78
Median	-3.65	43.57	24.84	28.67	75.20
Maximum	249.17	73.87	78.07	67.35	86.79
Minimum	-72.49	21.72	0.00	9.40	47.80
Std. Dev.	43.08	12.65	18.94	11.18	10.02
Observations	138	138	138	138	138

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Based on the descriptive test results above, it can be explained as follows:

Stock returns show a minimum value of -72.49 for PT Pollux Properties Indonesia in 2021. This indicates that during the pandemic year, property and retail companies experienced a significant decrease in stock prices, leading to an excessively high reduction in stock prices compared to before. The maximum value of 249.17 belongs to PT Harum Energy Tbk in 2021. This suggests that during the pandemic, mining and energy companies were relatively less affected, as evidenced by the continuous increase in their stock prices each year. However, the COVID-19 pandemic had a very significant impact on the overall stock prices of companies, as evidenced by the overall stock return of 6.45, which was caused by many companies experiencing negative returns during the pandemic COVID-19 period (2020-2021).

ESG performance is indicated by the ESG score obtained from the Bloomberg terminal. The minimum value is 21.72 for PT Tempo Scan Pasific in 2020. This indicates that even during the COVID-19 pandemic, the company still paid attention to non-financial performance. The maximum value is 73.87 for PT Indo Tambang Raya Tbk in 2021.

Environmental performance is indicated by the environmental score obtained from the Bloomberg terminal. The minimum value is 0, which means that there are companies that do not have any environmental score or performance. There are 9 companies that did not report their environmental performance score. The maximum value is 78.07 for PT Indo Tambang Raya Tbk in 2021.

Social performance is indicated by the social score obtained from the Bloomberg terminal. The minimum value is 9.40 for PT Indo AcidatamaTbk in 2019 and 2020. The maximum value is 67.35 for PT Bukit Asam Tbk in 2021. This suggests that social activities of companies increased during the pandemic.

Governance performance is indicated by the governance score obtained from the Bloomberg terminal. The minimum value is 47.80 for PT Solusi Bangun Indonesia Tbk in 2020-2021. The maximum value is 86.79 for PT Merdeka Copper Gold Tbk in 2021

The results of the model selection test.

Table1. Uji Chow Test

Redundant Fixed Effects Tests			
Effects Test	Statistic	d.f.	Prob.
Cross-section F	0.910757	(73,60)	0.6504
Cross-section Chi-square	102.9178	73	0.0121

The Hausman test results indicate that the probability value (cross-section random) is > 0.05, therefore, H0 is accepted, and the panel data regression uses the random effect model.

Table2. Lagrange Multiplier Test

Lagrange Multiplier Tests for Random Effects			
	Test Hypothesis		
	Cross-section	Time	Both
Breusch-Pagan	0.019217	0.481814	0.501031
	-0.8897	-0.4876	-0.479

The results of the Lagrange multiplier test show that the probability value (Breusch-Pagan) is > 0.05, therefore, H0 is rejected, and the panel data regression uses the random effect model. Based on the results of

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the model selection tests, the Chow test, Hausman test, and Lagrange multiplier test, the most appropriate model to use is the random effect model to examine the influence of audit committee characteristics on ESG performance. The results of the random effect regression are as follows:

Table3. The results of the Random Effect Regression Estimation

Dependent Variable: RETURN				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	32.61484	28.43662	1.146931	0.2535
ESG	0.016327	0.005973	2.733495	0.0071
ENVIRONMENT	0.491001	0.327079	1.501168	0.1357
SOCIAL	1.205354	0.470739	2.560556	0.0116
GOVERNANCE	-0.07964	0.454258	-0.17532	0.8611
Root MSE	41.33369	R-squared		0.072853
Mean dependent var	6.456594	Adjusted R-squared		0.044969
S.D. dependent var	43.08331	S.E. of regression		42.10347
Sum squared resid	235769.4	F-statistic		2.612692
Durbin-Watson stat	2.027783	Prob(F-statistic)		0.038208

Coefficient of determination (R2):

Table 4's findings reveal a coefficient of determination of 0.072853 or 7.2%. According to this, the independent variables ESG, environmental, social, and governance can account for 7.2% of the variation in the dependent variable, stock returns. Other factors outside the scope of this study have an impact on the remaining 92.3%.

F-test:

Table 4 show the probability value of the F-statistic is 0.038208. This indicates that the probability (F-statistic) is < 0.05, so H0 is rejected and H1 is accepted. Therefore, it can be concluded that ESG, environmental, social, and governance have a significant simultaneous effect on stock returns in companies listed on the Indonesian Stock Exchange during the period 2017-2021.

t-test:

Table 4 show it can be concluded that ESG performance has a probability value of < 1%, specifically 0.0071, with a positive regression coefficient of 0.016327, indicating that H1 is accepted. Similarly, social performance has a probability value of < 5%, specifically 0.0116, with a positive regression coefficient of 1.205354, indicating that H3 is accepted.

On the other hand, environmental performance has a probability value of > 10%, specifically 0.1357, with a positive regression coefficient of 0.491001, indicating that H2 is rejected. Similarly, governance performance has a probability value of > 10%, specifically 0.8611, with a negative regression coefficient of -0.079640, indicating that H4 is rejected

DISCUSSION

The Effect of ESG performance on stock returns

The results of the hypothesis demonstrate that ESG performance significantly increases stock returns. This means that the higher the ESG performance score of a company, the higher the stock returns obtained. This finding indicates that investors are more willing to hold companies with higher ESG scores than those with lower scores. For example, Institutional investors have a desire to include ESG into their investment strategies and may have mandates to do so (Chen et al. 2020). Individual investors are hesitant to fund businesses that harm the environment or act in a negative way toward society and employees, especially the younger generation. Additionally, investors holding companies with high ESG scores tend to have higher liquidity, which can be beneficial during market downturns associated with flight to quality (Chen et al. 2020; Luo 2022). These results align with (Li et al. 2022), who concluded that ESG practices can be utilized as risk management techniques to increase share price resilience, especially under adverse conditions.

The effect of environmental performance on stock returns

The hypothesis results show that environmental performance does not significantly impact stock returns. This means that investors decision to buy stocks does not consider high environmental performance. This finding suggests that investors are not interested in a company's environmental performance because it may not immediately impact the company's financial performance. Additionally, most companies may only implement environmental management based on minimum regulatory requirements, leading investors to perceive no added value for the company and themselves (Aditama 2022). These results contradict Almeyda and Darmansya (2019), where currently, the global financial markets consider ESG factors as one of the tools for investors' decision-making process.

The effect of social performance on stock returns

The hypothesis results show that social performance has a positive effect on stock returns. This means that the higher the social performance score of a company, the higher the stock returns will be. This finding indicates that investors pay significant attention to the social aspects carried out by a company. When a company benefits its stakeholders and other stakeholders, it gains acceptance within society, which leads to community support. Nabila and Wahyuningtyas (2023) Stated that the company's adherence to the GRI-G4 standard indicators, such as total workforce representation, employee benefits, and recruitment rates, reflects investor confidence in the company's performance for future prospects, leading to higher ratings. As a result, when a company implements these indicators, investors become more interested in investing in that company.

These results align with Sassen et al. (2016), who stated that better social performance and higher-quality social performance information disclosed enhance public trust in the company

The effect of governance performance on stock returns

The hypothesis results show that governance performance does not significantly impact stock returns. This means that the fluctuations in a company's stock returns are not caused by its governance performance, and investors may not consider governance performance as a reference in making investment decisions. Looking at the descriptive statistics, the average governance score of companies receives a higher value compared to the average environmental and social scores. This indicates that companies have already taken governance aspects into consideration, consistent with previous research. There is a possibility that when companies have disclosed their governance points effectively, investors are already confident that the company will maintain and improve its governance performance. As a result, the governance sector is no longer a criterion in investment decision-making. These results align with Aditama (2022) who stated that the tradition of governance disclosure has long been implemented in Indonesia, making governance performance an important consideration for stakeholders.

CONCLUSION

Conclusion

ESG performance positively impacts stock returns, indicating that non-financial factors are viewed by investors as a way to mitigate downside risk during crises. Environmental performance has little influenceon stock returns, suggesting that investors prioritize other factors over environmental concerns. Social performance has a positive effect on stock returns, indicating its significance in demonstrating a company's legitimacy to stakeholders. Governance performance, however, does not significantly affect stock returns, suggesting investors may perceive it as inadequate in overseeing management performance.

Suggest

Certainly, the topic of ESG (Environmental, Social, and Governance) performance and its impact on stock returns is a relevant and important area of research. The future research can add moderation variables such as profitability to examine the influence that can strengthen the relationship between ESG and stock returns

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