Research Article

Corporate Sustainability and Financial Performance: Evidence from State-owned Enterprises in Indonesia

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Abstract.
Corporate sustainability is a business approach to meet company needs and create stakeholders' value in the long term. This is reflected in the company's sustainable strategic planning and responsibility that is more inclusive and focuses on environmental, social, and corporate governance. This study aims to analyze whether corporate sustainability has an impact on the company's financial performance. The sample studied consisted of 13 listed State-owned Enterprises (SOEs) in Indonesia for the period 2017–2021. To measure corporate sustainability, independent variables consist of the three pillars of environment, social, and governance or ESG (environment, social, governance). The environmental pillar consists of three categories, namely resource use, emissions, and innovation. While the social pillar consists of four categories, namely labor, human rights, community, and product responsibility. Finally, the governance pillar consists of management, shareholders, and social responsibility strategy. The company's financial performance which is the dependent variable was measured using data on return on investment (ROI) and return on equity (ROE). Data analysis technique used is Automatic Linear Modeling using SPSS. The results of the study show a positive significant relationship between product responsibility (on the social pillar) with ROI and ROE. On the other hand, there is a negative significant relationship between management (on the governance pillar) to ROI and ROE. While other variables show no significant relationship to both ROI and ROE. The practical impact of this research will help academics, business entities, corporations, policymakers, regulatory authorities, and governments to better understand the relationship between sustainability and financial performance. It can also help companies to operate more effectively and efficiently in implementing corporate sustainability in state-owned enterprises in developing countries such as Indonesia.

Keywords: corporate sustainability, ESG, financial performance

1. Introduction

Sustainability has become a key area for researchers this decade, as it is imperative for companies to create value for their shareholders while meeting their social responsibilities to create a sustainable world [1]. Corporate sustainability has received a lot of attention in recent years as companies, investors, and consumers alike turn their attention to the increasingly important issue of corporate sustainability. The idea of sustainability also seems to have the potential to involve more strategists in stakeholder-based thinking. Sustainability is a multidimensional construct that involves all key stakeholders as well as the environment and society as a whole [2]. Sustainability is often viewed as a long-term goal, a concept encompassing environmental, social, and economic actions and outcomes [3].

Environment, Social, and Governance (ESG) ratings are increasingly being used, particularly by investors, to evaluate and select companies based on how companies interact with their stakeholders, the environment they can influence, and how they manage their governance. ESG ratings can therefore be seen as a good indicator of social and/or stakeholder responsibility [4].

In the last decade, governments, consumers, and investors have become more demanding and have demanded transparency on all issues affecting environmental, economic, and social dimensions. Therefore, many companies started publishing about sustainability, also known as Environmental, Social and Governance (ESG) reports. Many empirical studies have examined whether integrating ESG into a company's core processes rewards shareholders, increases profits and/or increases its valuation. The results remain unclear, inconclusive and sometimes contradictory. While most studies found a positive association between ESG integration and financial performance [5]; [6], few others found conflicting results and reported a negative relationship [7]; [8]. On the other hand, other study shows no statistical significance and relevance between corporate sustainability and financial performance [9].

Finally, in this global competition, the challenge of integrating different rules of international values and global legitimacy, including the implementation of sustainability, is an important issue that concerns all economic actors today, including State-owned Enterprises in Indonesia.

The aim of this paper is to expand on the previous coverage studies by explaining these relationships and complementing the existing literature by identifying how ESG aspects can impact financial performance while separately measuring and analyzing the impact of ESG components – environmental, social and governance – on the financial performance of 13 State-owned Enterprises in Indonesia for the period 2011 to 2021.

2. Literature Review

While shareholder value is initially described primarily as a short-term profit orientation, the concept increasingly leads to sustainable action for organizations that are more oriented towards long-term goals, so more and more activities are geared towards long-term shareholder value and sustainability [10]. Examining environmental, social, and governance (ESG) as a variable measuring corporate sustainability suggests that the trade-off between short-term returns and long-term value is tenuous, as companies with higher sustainability scores not only do better on environmental and social factors but also ensure higher returns expectations for the rightful owners [11].

ESG can be defined as a sustainability practice where actions and reports provide a basis for decision-making based on various non-financial information. ESG consists of three pillars made up of 10 categories, namely the environment pillar (resource use, emissions, innovation), social pillar (management, shareholders, CSR strategy) and governance pillar (workforce, human rights, community, product responsibility).

The understanding of corporate sustainability has not achieved universal validity [12], and inconsistent empirical evidence persists in this area of research [13]. Therefore, extensive literature is urgently needed in this area to improve understanding among practitioners and advance the literature [14].

Based on agency theory, corporations have a binding fiduciary duty to put shareholder needs and expectations first in order to create more wealth as an incentive for shareholders [7]; [15]; [16]. From a shareholder perspective, companies should invest in projects that maximize financial returns and minimize financial costs.

This study analyzes whether each of the pillars of environmental, social, and governance, which act as independent variables, has a positive impact on the company's financial performance. It is then examined whether each category of the environmental pillar has a positive impact on the financial performance of the company. The categories in the environmental pillar are resource consumption, emissions, and innovation. The categories on the social pillars are labor, human rights, community, and product stewardship. Finally, the categories are based on the pillars of governance management, shareholders, and CSR strategy. Accounting-based financial key performance indicators are used as the dependent variable, namely return on investment (ROI) and ROE (return on equity).

The actual attention to environmental issues has increased in the last few decades. Companies are increasingly realizing the importance of their responsibility to the environment and are working to adopt sustainable practices to reduce negative impacts on ecosystems. The recognition of environmental factors as pivotal components of a company's overall sustainability is underscored by the "Environment Pillar" within the purview of the Thomas Reuters Eikon guide. This pillar aptly captures the multifaceted dimensions through which businesses interact with the environment, encompassing aspects such as resource management, emissions reduction, and eco-friendly practices [4]. Along with that, the question arises whether these pro-environmental efforts can also affect a company's financial performance [17]. By identifying potential links between environmental practices and financial performance, we hope that the findings from this research can provide valuable insights for companies and society in understanding the importance of sustainability in a business context. In this study, we intend to test the hypothesis:

H1 : Environmental pillar has a positive influence on financial performance

The Social Aspect emphasizes social factors that affect company performance. Companies that integrate social aspects into their business strategy, with care for labor, human rights, community and product responsibility will reap long-term financial benefits [4]. The challenge of sustainability in business is further emphasized by Thomson Reuters Eikon's guidance through the Social pillar, which includes four key indicators. Workforce focuses on employee inclusion and well-being, while Community values the company's contribution to the well-being of the local community. Human Rights evaluates a company's human rights compliance, both internally and within its supply chain. Meanwhile, Product Responsibility reflects the company's responsibility for ethics, safety, and the social and environmental impacts of the products it produces. Companies exhibiting the highest levels of social performance possess an enhanced capability to convert their social investments into favorable financial outcomes, giving rise to the upward incline in financial returns [18]. This research aims to provide a deeper understanding of the importance of prioritizing social aspects in achieving optimal financial results. Therefore, the hypothesis of this study is :

H2 : Social pillar has a positive influence on financial performance

The Governance pillar in Thomson Reuters Eikon encompasses three key indicators that depict the essence of effective corporate governance in sustainable business practices [4]. The first indicator, "Management," assesses the quality of leadership, policy transparency, and risk management strategies. The second indicator, "Shareholder," highlights the role and engagement of shareholders in decision-making and profit distribution policies. Lastly, the third indicator, "CSR Strategy," reflects the company's commitment to social and environmental responsibility through sustainable social policies and programs.

The impact of corporate governance quality on overall financial performance remains a question of interest. Are efforts to implement good governance merely a matter of compliance with standards, or do they also offer long-term financial benefits to the company? Enterprises have the potential to enhance their financial performance through the implementation of appropriate corporate governance mechanisms [19]. This study aims to provide a deeper understanding of the significance of prioritizing governance aspects in achieving optimal financial outcomes. Therefore the hypothesis of this research is:

H3 : Governance Pillar has a positive influence on financial performance

The management of resources has become a critical issue in the pursuit of sustainable and environmentally friendly businesses. The Environmental pillar in Thomson Reuters Eikon's guidelines presents key indicators that allow companies to measure and understand their environmental impact. One of the primary indicators emphasized is 'Resource use', which pertains to the efficient and responsible use of resources [4].

Efficient and responsible resource use is not only a crucial objective in fulfilling social and environmental obligations but also holds the potential to impact a company's financial performance positively [20]. Green supply chain management as one activity of resource use helps firms to comply with environmental as well as assist such firms to improve their financial performance outcomes [21]. This research focuses on exploring the relationship between resource use, within the context of the Environmental pillar in Thomson Reuters Eikon, and a company's financial performance. This study aims to provide a deeper understanding of how company's performance and capacity to reduce the use of materials, energy or water, and to find more eco-efficient solutions by improving supply chain management and they can contribute positively to a company's financial success. Therefore, the hypothesis of this study is:

H4 : Resource use has a positive influence to financial performance

In the context of climate instability and growing awareness of environmental concerns, corporations are increasingly confronted with the responsibility to address the environmental impacts arising from their business operations. The Emission Reduction Score measures a company's commitment and effectiveness towards reducing environmental emission in the production and operational processes [4]. Is the focus on reducing emissions solely an environmental obligation, or could it also positively affect the company's financial outcomes? The actions undertaken by companies to effectively manage and mitigate emissions have the potential to yield substantial financial benefits. In this study, we aim to conduct data analysis to test hypotheses and gain valuable insights into how emission management contributes to a company's financial performance. As such, the research hypothesis asserts that:

H5 : Emission has a positive influence on financial performance

Highlighted within the Environmental Pillar of the Thomas Reuters Eikon guide, innovation serves as an indicator, shedding light on a company's dedication to pioneering practices within the framework of environmental sustainability. The Innovation Score gauges a company's ability to minimize the environmental expenses and encumbrances for its clientele, consequently paving the way for new market opportunities through the utilization of pioneering environmental technologies, processes, or eco-conceived products [4]. This research is focused on examining the relationship between innovation within the Environmental Pillar and a company's financial performance. Active adoption of sustainable innovative practices by companies is likely to confer a competitive advantage, ultimately leading to enhanced financial outcomes [22]. Therefore, placing a premium on sustainable innovation within a company's business and financial strategies assumes paramount significance, thus proposing the research hypothesis:

H6 : Innovation has a positive influence on financial performance

The workforce stands as a highly valuable asset for every company, and Thomas Reuters Eikon acknowledges the significance of social aspects in ensuring company sustainability, with workforce management being among the indicators. "Workforce" is identified as a key metric to gauge the extent of a company's commitment to employee well-being, diversity, training, and professional growth [4]. However, a crucial question arises concerning whether the company's investment and attention to employee welfare and development genuinely impact its financial performance. Can content and motivated employees indeed contribute positively to the company's financial outcomes, or is this emphasis solely a facet of social responsibility with no direct influence on financial performance? Hence, the research hypothesis is formulated as follows:

H7 : Workforce has a positive influence on financial performance

Business sustainability extends beyond economic and environmental concerns; it encompasses a commitment to addressing social issues, including human rights. Within the Thomas Reuters Eikon guide, the Social Pillar dedicates significant attention to "Human Rights" as a key indicator for assessing how companies treat their employees and the surrounding communities, thereby influencing human rights on a broader scale [4]. Companies that prioritize human rights, foster equitable and ethical work environments, and contribute to the well-being of local communities are likely to enjoy sustained financial benefits [23]. This study will focus on examining the connection between the "Human Right" indicator in the Social pillar of Thomas Reuters Eikon and a company's financial performance. Therefore, our research hypothesis posits that:

H8 : Human right has a positive influence on financial performance

The growing recognition of the company's role in supporting the local community is a significant aspect within the realm of business sustainability. Highlighted within the Thomas Reuters Eikon guide, the Social Pillar emphasizes the importance of considering

“Community” or society as a key component in the pursuit of sustainability. It measures the company’s commitment towards being a good citizen, protecting public health and respecting business ethics [4]. Companies that actively contribute to the sustainability of society, cultivating robust and mutually beneficial relationships with the surrounding environment, are likely to experience sustained financial advantages [24]. As a result, the hypothesis of this study is formulated as follows:

H9 : Community has a positive influence on financial performance

Amidst an era marked by heightened consumer awareness regarding the environmental and societal implications of products, product responsibility emerges as a vital facet of business sustainability. Within the Thomas Reuters Eikon guide, the Social Pillar recognizes that responsible products encompass not only quality and safety but also encompass considerations of environmental impact, production ethics, and customer involvement [4]. However, the pertinent question arises concerning the potential influence of a company’s dedication to product responsibility on its financial performance. Companies that prioritize responsible products, accounting for their social and environmental impacts, are likely to reap sustained financial benefits [25]. Thus, the research hypothesis posits:

H10 : Product Responsibility has a positive influence on financial performance.

Efficient management constitutes a fundamental pillar in ensuring both the triumph and enduring viability of a corporation. The Governance pillar within the framework of the Thomas Reuters Eikon guide underscores the significance of managerial aspects in attaining business sustainability [4].

Enterprises that foster effective, transparent, and sustainability-centric management are poised to yield persistent financial benefits [26]. This inquiry aspires to yield a more profound comprehension of the import of sustainable management in realizing superlative financial outcomes. Therefore, the hypothesis of this study is:

H11 : Management has a positive influence on financial performance

The indispensable role of shareholders in business continuity stands as an incontestable reality. Within the Governance pillar of the Thomas Reuters Eikon guide, the importance of the shareholder indicator in overseeing and influencing a company’s trajectory is aptly acknowledged. Amidst an ever-transforming and fiercely competitive business milieu, the concerns and requisites of shareholders represent pivotal determinants in shaping a company’s triumph.

In this inquiry, we endeavor to meticulously unravel the interrelation between the “Shareholder” indicator from the Governance pillar of the Thomas Reuters Eikon and the financial performance of companies. Enterprises that exhibit attentiveness to shareholder interests, coupled with a framework promoting equitable profit distribution, are poised to amass enduring financial gains [27]. Hence, the hypothesis of this study is as follows:

H12 : Shareholder has a positive influence on financial performance

The sphere of Corporate Social Responsibility Strategy (CSR Strategy) is progressively garnering heightened attention in endeavors towards attaining business sustainability. The Governance pillar within the construct of the Thomas Reuters Eikon guide duly acknowledges the import of the CSR Strategy facet in sculpting a company's enduring perspective and allegiance towards societal and environmental accountability [4]. Enterprises that deploy socially responsible strategies characterized by sustainability and a constructive influence on society and the environment stand poised to accrue enduring financial benefits [28]. Thus, the hypothesis of this study is:

H13 : CSR Strategy has a positive impact on financial performance

3. Research Methods

This study used secondary data collected from the Thomson Reuters Eikon database, State-owned Enterprises in Indonesia, for a five-year period from 2017 to 2021. The reason for choosing a state-owned enterprise as the subject of investigation is that BUMN is one of the enterprise actors that play an important role in various functions, including (1) market function (economy), (2) control function, (3) development function, (4)) social function, (5) strategic function, and (6) predator function [29].

Improving the performance of State-owned Enterprises, including Indonesia as one country in Asia, is a complex task given the many actors involved in oversight and management, which is why governments in recent decades have increased efforts to clarify the financial and non-financial objectives of SOEs, based on performance measurable targets and publish this information [30]. In Indonesia, based on Article 2 of Law No. Article 19 of 2003 on State-Owned Enterprises, one of the aims and objectives of establishing State-Owned Enterprises is to generate profit. More complexly, however, the existence of State-owned Enterprises is based on several functions and roles, namely: (1) contribution to the national economy and treasury revenues; (2) pursuit of profit; (3) meet the needs of many people; (4) pioneering business activities; (5) Provide support and protection to small businesses [31]

Data on Indonesia's State-owned Enterprises was extracted from the Thomson Reuters Eikon database. The aim of this empirical study is to examine the relationship between corporate sustainability and financial performance in SOEs in Indonesia. ESG scores are widely used as an indicator to measure sustainability practices [7]; [32]; [33]; [34]; [35]. ESG data as well as financial performance data such as ROI and ROE were extracted from the database in June 2023. To test the relationship of a single metric, we extracted the individual data for each of the Environment, Social, and Governance pillars.

A total of 117 State-owned Enterprises have been identified in Indonesia and actually only 13 companies are listed companies. The data is accessible and resides in Thomson Reuters' Eikon database, which discloses ESG scores for 2017-2021. The final sample includes 57 company annual observations for 13 companies from 2017 to 2021.

This study uses multiple variables to predict financial performance. For the empirical analysis, we deliberately chose an accounting metric because it can determine a company's business performance in achieving or generating a return on investments and profitability. Accounting-based metrics such as ROI and ROE are considered part of financial performance [35]; [36]; [37] Table 1. describes the dependent and independent variables in detail:

The data analysis technique in this study is automatic linear modeling using SPSS. Given the limitations of the traditional regression method, a new development in SPSS related to linear modeling is introduced: the linear method speeds up the process of data analysis through several automated mechanisms. This new technique represents an improvement over traditional techniques with respect to previous limitations, particularly in automatic variable selection and automatic data preparation.

For the regressions, we estimate the relationship in the two regression models since our independent variables are the same size. The regression model looks like this:

$$\begin{aligned} ROI = {} & \alpha + \beta_1 EPillar + \beta_2 E1 + \beta_3 E2 + \beta_4 E3 + \beta_5 SPillar + \beta_6 S1 + \beta_7 S2 + \beta_8 S3 \\ & + \beta_9 S4 + \beta_{10} GPillar + \beta_{11} G1 + \beta_{12} G2 + \beta_{13} G3 \end{aligned} \tag{1}$$

$$\begin{aligned} ROE = {} & \alpha + \beta_1 EPillar + \beta_2 E1 + \beta_3 E2 + \beta_4 E3 + \beta_5 SPillar + \beta_6 S1 + \beta_7 S2 + \beta_8 S3 \\ & + \beta_9 S4 + \beta_{10} GPillar + \beta_{11} G1 + \beta_{12} G2 + \beta_{13} G3 \end{aligned} \tag{2}$$

4. Results and Discussion

The automatic linear modeling result is estimated using two dependent variables and 13 independent variables as shown in Table 1. A summary of the relationship between corporate sustainability and financial performance is presented in Table 2.

Table 1: Dependent and dependent variables.

Variables	Types	Description
ROI	Dependent	Return on Investment (ROI) calculation uses net income data as a measure of profitability to total assets (Knight, Bertoche, 2015)
ROE	Dependent	The company's financial performance variables are measured by the ROI and ROE indicators (Khoiry, 2021).
Environment pillar	**Independent**	ESG practice score collected by the Asset4 database by Thomson Reuters
Resource use	Independent	
Emissions	Independent	
Innovation	Independent	
Social pillar	**Independent**	
Workforce	Independent	
Human rights	Independent	
Community	Independent	
Product responsibility	Independent	
Governance pillar	**Independent**	
Management	Independent	
Shareholders	Independent	
CSR Strategy	Independent	
Product responsibility	Independent	

Relationship Tested	ROI as Financial Performance			ROE as Financial Performance		
	Significance	Predictor Importance	Relationship	Significance	Predictor Importance	Relationship
Social Pillar to Final Performance						
Product Responsibility	0,004	0,410	Positive	0,000	0,858	Positive
Governance Pillar to Final Performance						
Management	0,000	0,470	Negative	0,045	0,142	Negative

Figure 1: Relationship of dependent variables by pillars and categories.

The first model is to analyze the relationship between sustainability (which consists of the pillar ESG variables and their categories) and the company's financial performance as measured by ROI. The regression result in this first model is that each ESG pillar individually has no relation to ROI. However, there are two ESG categories that have a significant association with ROI. First, the product responsibility category, which is part of the social pillar, has a positive correlation with ROI. Due to the significance of

0.004, which is less than 0.05, product responsibility has a significant impact on ROI and acts as an important predictor of ROI. Therefore, the relationship between these two variables is significant. The second category is the management of the pillars of governance, which is significant and negatively related to ROI, with the significance being 0.000 and negatively related to ROI.

The second model also consists of analyzing the relationship between sustainability and the company's financial performance, but the dependent variable is measured by ROE. Similar to the regression result in the first model, the regression result of ROE as the dependent variable is also unrelated to each ESG pillar individually. But, there are two ESG categories that have a significant association with ROE, which are product responsibility and management. The product responsibility significance of 0.000 for a positive relationship, while the management significance of 0.045 for a negative relationship. The predictor's importance for product responsibility and management are 0.858 and 0.142, so that concludes that product responsibility is very influential to the ROE.

5. Finding and Conclusion

This paper contributes to the existing literature on determining the link between ESG and the financial performance of SOEs in Indonesia. It can be seen that each pillar of environmental, social, and governance does not have a different impact on measuring the financial performance of SOEs in Indonesia. However, within each pillar, there are categories that have an impact on the financial performance of ROI and ROE. Product responsibility on social pillars influences the ROI and ROE, positively. On the other hand, there is a negative correlation between management in the governance pillar with ROI and ROE. While other variables show no relation to ROI and ROE.

Therefore, the implementation of ESG in Indonesian State-Owned Enterprises must be carefully planned and implemented. In other words, investment allocation decisions and expenses in the ESG pillar must be properly evaluated and monitored by taking into account the company's financial condition and resources so as not to impact the company's inefficiency. Taking into account that financial performance is a short-term condition, it is necessary to change the company's mindset towards developing better ESG, not only to achieve short-term profits or accounting-based financial performance measures but also for sustainable long-term profits.

6. Implications, Limitations, and Suggestions

It is expected that the implications of this paper will be useful for business entities, corporations, and stakeholders including government to consider costs and investment plans related to sustainability, especially State-Owned Enterprises. In addition, this paper can enrich the literature in the field of sustainability and serve as a reference for future research.

This study is not without limitations and therefore a number of studies are proposed for the future. Further studies will be useful by expanding the scope beyond the state-owned companies in Indonesia and conducting a comparative study that will help minimize the limitations of this paper as we have a relatively small sample size as we only focus on publicly traded ones focus on state-owned companies in Indonesia. Finally, future research could combine quantitative and qualitative methods to gain a deeper understanding of how sustainability can be integrated into stakeholder decision-making and engagement.

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