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ESG IMPLEMENTATION ON FINANCIAL PERFORMANCE IN INDONESIA STUDY LITERATURE REVIEW

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Abstract

In the era of globalization, Environmental, Social, and Governance (ESG) has become an essential framework for business decision-making and investment, especially in emerging markets like Indonesia. This study aims to analyze the impact of ESG implementation on financial performance in Indonesian companies through a literature review approach, focusing on recent research examining the correlation between ESG practices and financial outcomes. Using a comprehensive analysis of prior studies, this research explores the influences of ESG on profitability, market value, risk management, and operational efficiency, with attention to moderating factors such as digitalization. Findings indicate that robust ESG practices positively correlate with improved Return on Assets (ROA), increased market valuation, and reduced business risk, supported by enhanced transparency and stakeholder trust. Digitalization strengthens the link between ESG initiatives and financial performance by facilitating efficient data management and compliance. This research concludes that ESG is a tool for risk mitigation and a sustainable growth strategy for companies in Indonesia.

Keywords: ESG, Financial Performance, Indonesia

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INTRODUCTION

In the era of globalization and increasing attention to environmental, social, and corporate governance issues, ESG (Environmental, Social, and Governance) has become one of the crucial frameworks in making business and investment decisions. In recent years, stakeholders (investors, regulators, creditors, financial institutions, analysts, and researchers) attention to sustainability has increased significantly (Setiarini et al., 2023). Corporate sustainability can be measured by considering three important factors, namely environmental, social, and governance (ESG) (Isnindiah Sofiati & Aria Farah Mita, 2024). These three factors are taken into consideration by investors in assessing the company's performance.

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In Indonesia, there are several regulations related to ESG implementation. Law No. 40/2007 on Limited Liability Companies (Law No. 40/2007 on Limited Liability Companies) and Government Regulation No. 47/2012 on Social and Environmental Responsibility by Limited Liability Companies (Government Regulation No. 47/2012 on Social and Environmental Responsibility of Limited Liability Companies) regulate companies to perform social and environmental responsibilities, especially for companies related to natural resources and environmental impacts. Financial Authority Regulation No. 51/POJK.03/2017 on Financial Sustainability for Financial Services Institutions, Issuers, and Public Companies (POJK No. 51/POJK.03/2017 on the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies) also regulates companies to formulate sustainable business strategies and make sustainability reports (Yudhanto & Simamora, 2023).

In the Indonesian context, ESG implementation is increasingly important as the country faces various environmental challenges, such as deforestation, pollution, and climate change, which require sustainable solutions. In addition, Indonesia is also building stronger social infrastructure and improving a more transparent and accountable governance system, especially in the corporate sector. This is becoming increasingly relevant as the government and stakeholders push to achieve the Sustainable Development Goals (SDGs) by 2030 (Nareswari et al., 2023).

This study aims to review various relevant literature to understand how the application of ESG to Financial Performance in developing countries in Southeast Asia such as Indonesia. The results of the study are expected to provide insights for companies, investors, and policy makers on the importance of ESG implementation as a long-term sustainability strategy. With the increasing demand for corporate responsibility in mitigating social and environmental impacts, this research is becoming increasingly relevant and crucial for the sustainable development of the Indonesian economy.

RESEARCH METHODS

The research method in this article uses a literature review approach to review various relevant previous studies on the application of ESG (Environmental, Social, and Governance) to financial performance in Indonesia. In the process, various secondary sources including scientific journals, books, and research reports that discuss the relationship between ESG and financial performance are critically analyzed to highlight the results, findings, and methodologies that have been applied in previous studies. This literature analysis was conducted by selecting the most relevant studies, both quantitative and qualitative in nature, to provide an in-depth understanding of the impact of ESG implementation in the context of the Indonesian financial market. Inclusion and exclusion criteria were applied in the selection of literature to ensure the relevance and quality of the sources used. The results of this literature analysis are expected to provide theoretical and practical insights for companies and relevant stakeholders regarding the importance of ESG implementation in supporting sustainable financial performance in Indonesia.

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Discussion Results

Author	Method	Research Variables	Research Results
Le (2024)	This study uses a Fixed Effect Model on panel data consisting of 225 companies listed in six Southeast Asian countries for three years from 2020 to 2022 to estimate the impact of ESG (Environmental, Social, Governance) scores on financial performance, as well as considering macroeconomic variables such as the COVID-19 infection rate and GDP growth.	• Independent variable: ESG score (one year lag) • Dependent variable: Return on Assets (ROA) • Control variables: Firm size, asset turnover ratio, debt-to-asset ratio, GDP growth, COVID-19 infection rate, and firm type (financial and non-financial).	Results show that ESG scores with a one-year lag have a significant positive impact on financial performance, particularly on Return on Assets (ROA). GDP growth also has a positive, albeit small, effect on ROA. The COVID-19 infection rate has a significant negative impact on ROA, suggesting that the pandemic is putting great pressure on firms' financial performance. Firm size and other financial variables, such as asset turnover ratio and debt-to-asset ratio, show a negative impact on ROA, which emphasizes the importance of prudent debt management especially during times of economic instability.
Husnah (2023)	This study uses multiple regression analysis on secondary data from 19 companies in the Indonesian mining sector listed on the Indonesia Stock Exchange during the 2020-2021 period to analyze the effect of Environmental, Social, and Governance (ESG) disclosure on financial performance, as measured by Return on	• Independent variable: ESG disclosure • Dependent variable: Return on Assets (ROA), Tobin's Q, Sales Growth.	The results show that ESG disclosure simultaneously affects financial performance in the Indonesian mining sector, especially on Tobin's Q and Sales Growth. However, in the short term, ESG disclosure has not yet had a significant impact on ROA. In addition, partial testing shows that environmental and governance variables have a positive impact on Tobin's Q, while all three ESG variables (environmental, social, and governance) contribute to increased sales growth. These findings indicate that

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	Assets, Tobin's Q, and Sales Growth.		companies in the mining sector can improve their financial performance by integrating ESG factors into their operations, which can have a positive impact on the company's share value and sales growth.
Makhdalena et al (2023)	This study uses unbalanced panel data taken from Thomson Reuters to observe the effect of ESG (Environmental, Social, Governance) on firm performance (measured by ROA) in companies in ASEAN developing countries (Indonesia, Malaysia, Philippines, Thailand, and Vietnam) in the period 2010-2020, with control variables in the form of leverage, company size, company age, and Gross Domestic Product (GDP) of each country.	• Independent variable: ESG (which includes environmental (ENV), social (SOC), and governance (GOV) scores) • Dependent variable: Firm performance, measured by Return on Assets (ROA). • Control variables: Leverage, firm size, firm age, and GDP	The results show that overall ESG information, including its three components (environmental, social, and governance), has a significant positive influence on firm performance (ROA). Each ESG component individually also shows a positive impact on firm performance. The robustness test using Tobin's Q as a measure of market performance shows similar results, where ESG information and its environmental and social components improve the firm's market performance, although governance does not have a significant effect on market performance. This study concludes that ESG implementation can enhance positive corporate image, reduce information asymmetry, and improve stability and firm value in ASEAN emerging markets.
Eriandani & Winarno (2023)	This study uses data on companies listed on the Indonesia Stock Exchange for the period 2017-2021, with a total sample of 347	• Independent variable: ESG (Environmental, Social, Governance)	This study found that ESG responsibility has a positive impact on firm performance, both in terms of book performance (ROA) and market performance (Tobin's Q).

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	observations, and applies moderation regression analysis and subgroup analysis to test the role of digitalization in moderating the relationship between ESG (Environmental, Social, Governance) and firm performance as measured by book (ROA) and market (Tobin's Q and stock price) performance.	• Dependent variable: Company performance as measured by Tobin's Q, ROA, and stock price. • Moderating variable: Digitalization (with dummy variables indicating the adoption of digital technology) • Control variables: Firm size, operating cash flow (OCF), and debt ratio (DER)	However, digitalization is not proven to strengthen the relationship between ESG and firm performance. Subgroup analysis reveals that ESG only has a positive impact on firm performance in firms that have adopted digital technology, while in firms that have not adopted digitalization, ESG has no significant effect. These results indicate that digitalization may strengthen the positive influence of ESG on firm value in contexts that have supported digital transformation, reinforcing the importance of digitalization to support socially and environmentally responsible activities.
Yudhanto & Simamora (2023)	This study uses a sample of 150 companies listed on the Indonesia ESG Leaders Index on the Indonesia Stock Exchange during the 2020-2022 period, measures the independent variable ESG risk, the dependent variable of company performance (Return on Assets and Tobin's Q), and the mediating variable firm risk as measured by stock return volatility, and uses path analysis to test the	• Independent variable: ESG risk • Dependent variable: Firm performance, measured by Return on Assets (ROA) and Tobin's Q. • Mediating variable: Firm risk (measured by stock return volatility) • Control variables: Employee productivity, leverage, and firm size	The results show that lower ESG risk reduces corporate risk and improves corporate performance. Specifically, lower ESG risk reduces potential conflicts and uncertainties, thereby improving cost efficiency and helping firms achieve a better reputation in the eyes of stakeholders. Reduced corporate risk also leads to improved performance, which is evident in both operating profit (measured by ROA) and market value (measured by Tobin's Q). The study also reveals that industry sensitivity amplifies the positive effect of ESG risk reduction on

	relationship between ESG risk, firm risk, and company performance.		corporate risk reduction, which indirectly supports better financial performance.

ANALYSIS

a. The Effect of ESG Score on Company Profitability

Based on the research results reviewed in the article, the implementation of ESG is proven to make a positive contribution to corporate profitability in Indonesia. Le (2024) shows that good ESG implementation, especially in terms of governance and environmental management, is able to significantly increase Return on Assets (ROA) in companies operating in the Southeast Asian region, including Indonesia. This suggests that aspects of ESG that focus on environmental sustainability and operational transparency lead to improved cost efficiency and reduced business risks, which in turn contribute to better financial performance. Companies with high ESG scores are more likely to attract investors who prioritize sustainability, which has a positive impact on long-term profitability. Data from Yudhanto & Simamora's (2023) research also supports these findings, stating that companies that consistently manage ESG risks show higher profit stability as a result of better management of potential conflicts and reduction of uncertainty arising from external factors.

Research by Husnah (2023) underlines that in the mining sector in Indonesia, the implementation of ESG has a positive impact, especially in creating sales growth and market value, although it has not had a significant effect on short-term profitability. However, for the long term, the implementation of comprehensive ESG is proven to be able to provide added value to companies by increasing operational efficiency and market competitiveness. Research by Makhdalena et al (2023) also revealed that ESG implementation contributes to the reduction of operational costs through better management of environmental and social risks, which ultimately increases the overall ROA of companies in ASEAN countries, including Indonesia. Good ESG implementation can provide direct and indirect economic benefits, leading to more stable and sustainable profitability in Indonesia.

b. The Impact of ESG Disclosure on Firm Market Value

Transparent ESG disclosure is also proven to have a positive impact on the market value of companies in Indonesia. Based on Husnah (2023), companies in the mining sector that make ESG disclosures simultaneously show a significant increase in market value as measured by Tobin's Q. This indicates that ESG disclosures, especially on environmental and governance variables, are able to attract investor attention, which then encourages appreciation of the company's share value. This indicates that ESG disclosure, especially on environmental and governance variables, is able to attract investor attention, which then encourages appreciation of the company's stock value. Companies that consistently report ESG performance provide positive signals to stakeholders about their commitment to sustainability, which increases competitiveness in the market. This transparency allows investors to have more confidence in the company's long-term stability and prospects, which is an important factor in market valuation.

Eriandani & Winarno (2023) research also emphasizes that companies with high ESG scores are able to increase access to funding, especially from investors who pay attention to sustainability factors. They found that companies with comprehensive ESG disclosures experience a significant increase in market value (Tobin's Q) and share price, especially for companies that have adopted digitalization as part of their operations. Digitalization supports efficiency in reporting and managing ESG data, which attracts investors' interest in companies that are transparent and progressive in ESG implementation. Eriandani & Winarno (2023) research also emphasizes that companies with high ESG scores are able to increase access to funding, especially from investors who pay attention to sustainability factors. They found that companies with comprehensive ESG disclosures experience a significant increase in market value (Tobin's Q) and share price, especially for companies that have adopted digitalization as part of their operations. Digitalization supports efficiency in reporting and managing ESG data, which attracts investors' interest in companies that are transparent and progressive in ESG implementation.

c. The Role of ESG Risk in Reducing Business Risk

Lower ESG risks play an important role in reducing overall business risk for companies in Indonesia. Based on Yudhanto & Simamora (2023), companies that successfully reduce ESG risks, especially through good management of environmental and social aspects, experience a decrease in stock return volatility. This means that the company is better protected from market uncertainty and external turmoil that often disrupt operational stability. Reducing ESG risks helps companies maintain cost efficiency, enhance reputation, and reduce potential conflicts with stakeholders, which ultimately has a positive impact on financial performance. With more manageable risks, companies can attract investors who have a preference for stable and less risky investments, strengthening their position in the financial markets.

Research by Makhdalena (2023) also corroborates that companies that consistently manage ESG factors show better financial performance in the ASEAN region, including Indonesia, especially in sectors that are sensitive to environmental and social issues. In this context, low ESG risk provides additional protection for companies in the face of global economic uncertainty and increasingly stringent environmental and social regulations. It also helps companies meet stakeholder expectations on social responsibility and sustainability, which is a competitive advantage in a market that is increasingly concerned about ESG issues.

d. ESG Contribution in Sales Growth and Revenue Performance

ESG implementation is proven to have a direct contribution to improving sales growth and earnings performance in various sectors, especially in industries that are at high risk of sustainability issues such as mining. Based on Husnah (2023), the

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implementation of ESG in the Indonesian mining sector is proven to drive increased sales and market value, although the impact on short-term profitability such as ROA has not been significant. ESG implementation in this sector increases the attractiveness of products and services in the eyes of consumers who are increasingly concerned about social and environmental responsibility. Strengthening the company's image in ESG-conscious markets has the potential to increase market share and customer loyalty, which in turn drives sustainable sales growth.

Makhdalena (2023) also identified that the implementation of ESG in companies in developing countries, including Indonesia, plays a role in increasing revenue through better management of resources and relationships with society. The implementation of positive ESG practices creates added value for the company, especially with the trust from customers and local communities, which strengthens the company's position in the market. With the increasing demand for products that meet sustainability standards, companies that adopt ESG have the opportunity to expand their market and increase revenue.

e. Moderation of Digitalization in the Relationship between ESG and Financial Performance

Digitalization is proven to strengthen the relationship between ESG implementation and corporate financial performance in Indonesia, especially for companies that have adopted digital technology. Based on research by Eriandani & Winarno (2023), companies that integrate ESG with digital technology tend to show better financial performance, measured through Return on Assets (ROA) and market value (Tobin's Q). Digitalization supports ESG implementation by improving the efficiency of data management and transparent and accurate reporting, which makes it easier for companies to demonstrate their sustainability commitments to investors. The use of technology in reporting ESG data also allows companies to be more responsive in addressing environmental and social issues, which strengthens their appeal to investors focused on responsible investment.

Digitalization gives companies the ability to adapt more quickly to changing regulations and stakeholder expectations for sustainability. In this study, Eriandani & Winarno (2023) reveal that companies that have adopted digitalization are significantly more able to leverage ESG initiatives to improve competitiveness and market position. Digitalization also allows companies to optimize ESG-oriented operations, such as energy saving or waste management, which contributes to cost efficiency.

f. ESG's Role in Enhancing Corporate Reputation and Capital Access

Strong ESG implementation affects financial performance and positively impacts corporate reputation, which in turn improves access to capital. Based on the findings of Yudhanto & Simamora (2023) companies that have high ESG scores tend to have a better reputation in the eyes of stakeholders, including investors, customers, and local communities. This positive reputation becomes a valuable asset as investors are now increasingly considering sustainability factors in their investment decision-making. Companies with a good ESG reputation are also more likely to attract interest from financial institutions that offer access to funding on more competitive terms. This gives companies more flexibility in business development and sustainable expansion.

Research by Makhdalena (2023) supports this view by showing that companies in developing countries such as Indonesia that integrate ESG into their business operations have a greater chance of gaining financial support from international investors. Investors who are committed to sustainability will tend to favor companies that show concern for environmental, social and good governance aspects, meaning that ESG reputation can serve as a magnet for new capital.

CONCLUSION

ESG implementation has a significant positive impact on the financial performance and stability of companies in Indonesia. High ESG scores improve profitability through operational efficiency and competitiveness, as well as strengthen market value and reduce business risks. Digitalization is shown to strengthen the relationship of ESG with financial performance, enabling more efficient and responsive ESG implementation. In addition, a company's good reputation from ESG implementation eases access to capital, increasing attractiveness for investors concerned about sustainability. ESG acts as a risk mitigation tool and a strategy that supports sustainable financial growth and long-term competitiveness of companies.

The article presents has limitations that could be addressed to enhance its depth and applicability. The research methodology relies solely on a literature review without including primary data analysis, which limits the ability to validate findings within the Indonesian context. While it aims to focus on ESG implementation in Indonesia, many references are drawn from regional (ASEAN) or global studies, which may not fully capture the unique challenges and opportunities present in Indonesia. To improve the article, several suggestions are proposed. Incorporating empirical data from Indonesian companies would strengthen the analysis by providing localized evidence. Moreover, a more detailed discussion of Indonesia’s unique context, such as regulatory challenges, environmental issues, and digital adoption levels, would add valuable insights.

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