

Research Horizon

ISSN: 2808-0696 (p), 2807-9531 (e)

Research Horizon

Volume: 04

Issue: 04

Year: 2024

Page: 197-204

Analysis of Financial Characteristics of Sustainability Report: Company Size as Moderating Variable

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Abstract

Environmental, social, and governance disclosure are important for corporations to enhance their performance in these areas. In Indonesia, only a few businesses produce sustainability reports. This study seeks to investigate the role of firm size in moderating the influence of profitability, liquidity, and leverage on sustainability performance as measured by ESG disclosures in non-financial companies listed on the Indonesia Stock Exchange (IDX) from 2018 to 2022. Using the purposive sampling strategy, 61 sample companies were identified. The data was analyzed using the SEM-PLS approach and the Smart PLS 3.0 application. The findings revealed that profitability has insignificant influence but positively on ESG disclosure, whereas liquidity and leverage have a significant effect but negatively on ESG disclosure. Company size was able to moderate by increasing the effect of liquidity and leverage factors on ESG disclosure, but not profitability. The study's findings support stakeholder theory in terms of the company's attempts to develop and publicize its sustainability report.

Keywords

Company Size, Financial Characteristics, Sustainability Performance, Sustainability Report

1. Introduction

In recent years, the topic of sustainable development has grown in importance. This is due to contemporary business competitiveness, which requires organizations to improve and sustain their value through long-term performance. However, many businesses remain focused on improving their financial performance. If this is the case, the company's long-term viability is threatened. Traditionally, firm success was measured using economic indicators, but today's approach is more comprehensive. The word sustainable performance can be defined as a corporate perspective that takes into account economic, social, and environmental factors (Rashid et al., 2017). Non-financial reports, company sustainability reporting, organization social responsibility disclosures, governance, social, and environment reports are all examples of sustainable performance reporting. Companies can use sustainability report disclosure to communicate and report on their plans, goals, and actions to stakeholders using indicators of sustainable performance (Hanifah & Wijayanti, 2023).

The Financial Services Authority (*Otoritas Jasa Keuangan/OJK*) number 51/POJK.03.2017 established regulations which regulate the disclosure of corporate sustainability reports in Indonesia, stating that in order to achieve reliable and inclusive sustainable development, a national economy that prioritizes harmony among economic, social, and environmental factors is required. In addition to yearly reports, the OJK mandates financial institutions, issuers, and publicly traded corporations to prepare sustainability reports. The company's sustainability report is released separately from its annual report, and numerous firms participate in the Indonesia Sustainability Report Award. Corporate sustainability performance is measured by several measures, including environmental, social, and governance (ESG) disclosure. ESG reporting can be an instrument of communication for the organization and its many stakeholders. ESG reporting is a means of informing the public that a company's operations are focused not just on profits but also on its responsibilities to the environment and society as a whole (Rahman & Alsayegh, 2021).

The low adoption rate of ESG report disclosure in Indonesia is the phenomenon that takes place. According to a 2019 Center for Risk Management and Sustainability report, just 4.9% of businesses have integrated ESG disclosures, and such disclosures are still lacking. This demonstrates that Indonesia's use of ESG is still not at its best (Rohendi et al., 2024). Research has also demonstrated that, in comparison to other ASEAN nations, Indonesia discloses sustainability information at a lower level (Loh & Thomas, 2018). Indonesia ranked lower (40.6%) than Malaysia (54.4%), Singapore (50.8%), Thailand (48.9%), and the Philippines (48.1%) in terms of environmental transparency, according to the data. Comparably, Indonesia ranked lower (52.1%) than Malaysia (60.6%), Singapore (55.7%), and Thailand (56.3%) in terms of social transparency. Out of the five ASEAN nations that were examined, Indonesia has the fifth-highest level of sustainability report disclosure overall.

There are various factors that influence the disclosure of sustainable reports. Previous research on factors that influence the disclosure of sustainable reports shows varying results. Research by Yohana & Suhendah (2023) states that the performance of sustainable report disclosure is influenced by profitability. In addition, other studies show negative results (Karaman, 2018; Risa et al., 2021; Damayanti & Hardiningsih, 2021; Doktoralina et al., 2018). According to research Vianinnda (2022); Tumewu (2017), liquidity affects the disclosure of sustainability reports positively, while others show negative results (Sonia & Khafid, 2020; Islamiati & Suryandani, 2021; Doktoralina et al., 2018). Previous studies have also investigated the relationship between leverage and sustainability report disclosure.

According to Rahman & Alsyaeigh (2021); Amosh et al. (2022); Karaman (2018); Yohana & Suhendah (2023); Dewi & Budiasih (2021) leverage positively affects sustainability report disclosure. Meanwhile, other studies show negative results. Company size is used as a moderating variable because some previous research results show relatively consistent significance between the influence of profitability, liquidity, and leverage, on sustainable report disclosure. The use of company size is assumed to strengthen variable associated with ESG disclosure. This research focused on non-financial firms. Non-financial sectors are more likely to have a negative environmental and social impact than financial corporations. As a result, this study aimed to investigate and assess the influence of profitability, liquidity, and leverage on ESG disclosure, as well as the role of firm size as a moderating variable in non-financial firms listed on the Indonesia Stock Exchange.

2. Literature Review

The theory underlying this study is legitimacy theory and stakeholder theory. The stakeholder theory states that a firm that runs a business must not only focus on internal interests, but also on the well-being of its stakeholders, which include creditors, debtors, consumers, society, and others. ESG is now the most used sustainability measuring standard used to ensure corporate accountability (Howard, 2021). The notion of sustainable report disclosure may also be described using legitimacy theory, which states that in order to acquire legality from society, a corporation in operation must conform with the rules and regulations that exist in society. This is because the business engages socially with society at large in the context where it performs operational activities and utilizes economic resources to obtain community legitimacy (Ghozali & Chariri, 2014). Corporate capacity to continue its operations in the long run and to make a profit can be described by profitability. In general, the study is carried out by comparing a period's achievements to those of the preceding one. Companies that are very profitable will be driven to engage in environmental efforts. Companies with great profitability are seen to be capable of enduring the costs involved with publishing sustainable report information to legitimize their presence in society.

H1: *Profitability positively has significant effect on ESG disclosure.*

Another financial performance metric utilized in this study is liquidity, it assess the company's ability to utilize its assets to pay its short-term debts. Companies can use the current ratio to determine liquidity, which assesses how well the company using its assets to cover its short-term debts (Brigham & Houston, 2019). The theory of stakeholders shows that the firm will make an attempt to release information in order to maintain a favorable image with stakeholders. This information may be used to persuade creditors to collaborate and demonstrate that the firm is financially stable, namely one in which the corporation can manage its existing assets to meet its short-term commitments.

H2: *Liquidity positively has significant effect on ESG disclosure.*

The degree of leverage, which represents the proportion of corporate debt, determines whether the corporation can efficiently manage its capital to pay its financial obligations. Creditors prefer firms that provide more comprehensive sustainability disclosures and are hesitant to accept low-quality information. Thus, loan holders prefer to monitor companies with high leverage and urge them to publish more sustainability report information in order to offer evidence of legitimacy and guarantee of the company's financial performance (Rahman & Alsyaeigh, 2021).

H3: *Leverage positively has significant effect on ESG disclosure.*

The size of a company, determined by total assets, shows how much assets it has. According to legitimacy theory, the higher a company's scale, the more likely it is to attract public notice. Shareholders and stakeholders exert pressure on the corporation to meet its commitments, namely increasing financial and social performance. This condition encourages businesses to participate in actions linked to environmental and social preservation. Because of the high cost, these operations can only be carried out by enterprises with a large asset base (Laguir et al., 2018). This demonstrates that corporations with strong financial success and large-scale backing may engage in social initiatives to obtain public legitimacy. The quantity of social activities carried out influences the amount of information revealed by the firm in its sustainability report. Improved sustainability performance has an influence on the company's long-term viability. Companies that can manage equity to meet their responsibilities demonstrate solid financial health, which will allow them to continue contributing to social programs in the long-term.

H4: *Company size moderates the influence of profitability, liquidity, and leverage on ESG disclosure.*

3. Methods

The data used in this research is secondary data which were gathered from the Bloomberg database as well as the company's yearly financial statements. The research population for this study consisted of non-financial sector businesses listed on the Indonesia Stock Exchange between 2018 and 2022. This study's sample was selected using a purposive sampling strategy. Sekaran & Bougie (2016) states that sample is a part of the population that may be used to represent the whole. Samples are drawn from the population using certain criteria. From the overall population, 61 non-financial sector enterprises were selected. The data were then analyzed using PLS using smart-pls 3.0. Table 1 provides the descriptions of operational variables in this research:

Table 1. Descriptions of Operational Variables

Variable	Indicators	Description	Ratio
ESG Disclosure	ESG Score	Environmental, social, and governance disclosure scores compiled by Bloomberg ESG Database.	Percentage of total items disclosed by the company with a score range of 0 - 100 through the ESG disclosure score on Bloomberg.
Profitability	Return On Equity (ROE)	A metric that assesses a corporate capacity to create profits by comparing profit after tax to its capital.	Net profit/shareholder's equity
Liquidity	Current Ratio (CR)	A metric that evaluates the current resources to its debt of company.	Asset/current debts
Leverage	Debt to Equity Ratio (DER)	The proportion is utilized to calculate the company's ability to repay all of its financial obligations using its capital.	Amount of debt/owner's equity
Company Size	Company Size (SZE)	The total assets controlled by a firm serve as a measure of its size.	Ln (asset)

4. Results and Discussion

According to Ghozali & Latan (2020), PLS analysis consists of two measurement sub-models: the outer model and the inner model. The outcomes of the outside and

inner model evaluations are explained as follows: The measurement outer model evaluation uses several criteria to determine the validity and reliability of each latent variable indicator.

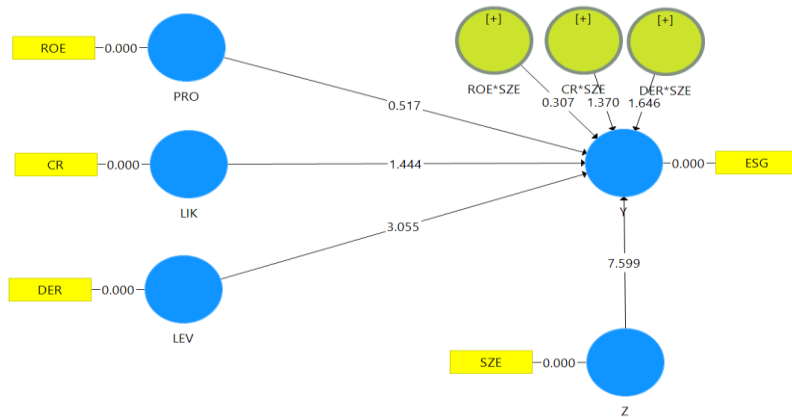


Figure 1. Outer Model

Figure 1 depicts the findings of the study's outer model, which included profitability (ROE), liquidity (CR), and leverage (DER) variables as independent factors, firm size as a moderating variable represented by SIZE, and ESG disclosure as the dependent variable. The study's model fits quite well. The results show that the composite reliability value for each construct above is quite excellent ($1.00 > 0.70$). The full collinearity VIF value for each construct is < 3.3 , indicating that the model is devoid of vertical, lateral, and common method bias collinearity concerns. Because the value of all constructions is more than 0.70, it can be argued that each construct has a high dependability value (model fit). The inner model assesses the correctness of the research model by a variety of methods, including the link between constructs, the significant value, and the coefficient of determination (R-square).

Table 2. Coefficient of Determination

Variable	R-square	R-square Adjusted
ESG Disclosure	0.185	0.163

The construct validity of ESG disclosure is shown by R-square value, namely 0.185, or 18.5 %. It means that the construct validity of return on equity, current ratio, and debt to equity ratio can only influence 18.5% of ESG disclosure, while the 81.5 % is affected by other factors. The structural model evaluation indicates that the Adjusted R-squared variation value affecting ESG disclosure falls in the very weak category (< 0.25) and is impacted by factors outside the research model. Hypothesis testing is performed by comparing the statistical t-test findings to the p-values from the bootstrapping technique.

Table 3. Path Coefficients

Variable	Std. Dev.	T Statistic	P Values
ROE -> ESG Disclosure	0.065	0.517	0.303
CR -> ESG Disclosure	0.080	1.444	0.075*
DER -> ESG Disclosure	0.089	3.055	0.001***
ROE*SIZE -> ESG Disclosure	0.060	0.307	0.379
CR*SIZE -> ESG Disclosure	0.072	1.370	0.086*
DER*SIZE -> ESG Disclosure	0.091	1.646	0.050**

Note: * $p < 10\%$ ** $p < 5\%$ *** $p < 1\%$

According to hypothesis 1 testing, profitability has substantial but not significant impact on ESG disclosure, hence hypothesis 1 is rejected. This is demonstrated by the coefficient value of profitability, which has a positive direction of 0.034 and a significance value of 0.303, indicating that the value exceeds 0.05. This demonstrates that the high and low values of profitability possessed by the corporation have no influence on the disclosure of sustainable performance. All businesses (both profitable and unprofitable) are required to submit sustainability reports. According to legitimacy theory, a high profitability value shows that the firm can generate profits, which may be reinvested in activities that promote long-term performance in order to preserve its legitimacy among stakeholders. However, in order to address global economic difficulties and expansion, corporations must make significant savings, resulting in lower ESG investment costs. The lack of action in ESG management has an influence on the company's low ESG disclosure level. This is consistent with other studies Karaman (2018); Vianinnda (2022); Risa et al. (2021); Damayanti & Hardiningsih (2021); Doktoralina et al. (2018), which found that sustainability disclosure was not influenced by profitability.

Hypothesis 2 testing reveals that liquidity has a substantial impact but negatively on ESG disclosure, hence hypothesis 2 is rejected. This is demonstrated by the coefficient value of liquidity, which has a statistically negative (-0.116) and p value of $0.075 < 0.1$. This demonstrates that the value of liquidity has a direct impact on ESG disclosure under present conditions. That is, the more liquidity the corporation has, the less likely it is to report ESG, and vice versa. Another explanation is that organizations with high liquidity are more likely to prioritize liquidity management in their company operations in order to improve their financial performance. Thus, firms assume investors will be more interested in investing their funds.

Hypothesis 3 testing reveals that leverage has a substantial impact but negatively on ESG disclosure, hence it is rejected. The leverage coefficient value is -0.273 with p value of 0.001 (< 0.05). This demonstrates that the higher the debt, the less likely a corporation is to publish ESG. The company's large leverage is not used for ESG investment, but rather to enhance earnings and demonstrate success to investors. This is consistent with study undertaken (Vianinnda, 2022; Damayanti & Hardiningsih, 2021; Sonia & Khafid, 2020; Islamiati & Suryandani, 2021; Doktoralina et al., 2018).

Company size moderates the impact of profitability, liquidity, and leverage on ESG disclosure. According to hypothesis 4 testing, firm size does not support the influence of profitability on ESG disclosure (significance value $0.379 > 0.05$), hence hypothesis 4 is rejected. Meanwhile, firm size can strengthen the influence of liquidity and leverage on ESG disclosure with a significant value of less than 0.1 (0.086 and 0.050), implying that hypotheses 5 and 6 can be accepted. This demonstrates that firm size is not the only element that corporations use as a benchmark when submitting sustainability reports. The operational volume of a corporation increases as it grows in size. As a result, stakeholders will prioritize information related to high profitability performance over information linked to the publication of sustainability reports. When corporate size is taken into account, the influence of liquidity on ESG disclosure becomes stronger. This demonstrates that, even if the company's liquidity is strong, if it is supported by big assets, it will affect the publication of sustainability reports. Large corporations not only manage liquidity for economic operations, but also engage in environmental actions. Thus, investors believe and are more interested in investing based on the company's size. When corporate size is concerned, the influence of leverage on sustainable report disclosure is also considerable. Company size may be changed. This study is consistent with stakeholder theory and demonstrates that large organizations may manage high debt to improve financial and sustainability performance. Despite the high degree of corporate debt, stakeholders trust major corporations since they

publish information on long-term success. These findings are similar to prior studies Purnama & Handayani (2021) and Handayani & Wahyudin (2020).

5. Conclusion

This study discovered that profitability (ROE) positively affected ESG disclosure but not significant. The liquidity ratio (CR) and Leverage (DER) have a significant influence but negatively on ESG disclosure. Company size (SZE) cannot strengthen the impact of profitability on ESG disclosure but it can improve the link between the effects of liquidity and leverage on ESG disclosure. This study has limitations, including R-square value of 18.5 %, implying that the ROE, CR, and DER factors can only influence 18.5 % of ESG disclosures, with the other 81.5% influenced by variables not used in this study. Therefore, future researchers are expected to add other variables outside the research model, which aims to obtain more accurate research results and generally occur in all companies. In addition, the object used in this study is only limited to the non-financial sector, so it cannot be generalized to all companies. Further research can expand the research object to one type of industry to get more specific results. We also suggest future research to use other measurement of sustainability reports, such as GRI index, CSR disclosure, and etc.

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