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# ESG Risk Ratings, Financial Performance and Corporate Value: The Case of The Indonesia Stock Exchange

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**ABSTRACT**

The integration of Environmental, Social, and Governance (ESG) factors into corporate strategies has become increasingly relevant, particularly in the post-pandemic era. As businesses face new challenges in a rapidly changing environment, understanding the impact of ESG factors on corporate performance has gained significance. This study examines the relationship between ESG risk ratings, financial performance, and corporate value for companies listed on the Indonesia Stock Exchange in 2023. A multivariate regression analysis with a cross-sectional data approach is used, employing Stata 17 software for data processing and analysis. The ESG risk ratings are analyzed through four models: overall ESG risk rating, low ESG risk rating, medium ESG risk rating, and high ESG risk rating, with Return on Assets (ROA) as an independent variable, and corporate size, leverage, and liquidity as control variables. The results indicate that none of the ESG risk rating models significantly influence corporate value. Although financial performance shows a positive but statistically insignificant effect, corporate size has a positive and significant effect on corporate value. However, leverage and liquidity were found to be statistically insignificant across all models. The study also highlights that during the pandemic, efforts made by companies in the field of ESG were not perceived by investors as a factor that could increase the company's value. Instead, these efforts were viewed as necessary steps for companies to survive in the economic crisis, without considering the long-term potential of improving performance and value.

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## INTRODUCTION

In recent years, investors, lenders, and other stakeholders worldwide have increasingly integrated Environmental, Social, and Governance (ESG) factors into their business decisions (Feng & Wu, 2023). This change is driven by the potential of ESG in creating sustainable businesses, which has a positive impact on financial performance and corporate value (Abdi et al., 2022). Investors believe that non-financial information, such as the company's impact on climate change, its contribution to society and stakeholders, and its governance and

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oversight structures, plays an important role in supporting the sustainability of the company and the global economy (Giannopoulos et al., 2022).

However, defining ESG disclosure criteria remains challenging, with significant disagreement among ESG data providers regarding their application (Feng & Wu, 2023). ESG scores also face various issues related to the coverage, measurement, and weighting of each ESG pillar (Dupuy & Garibal, 2022). This issue affects the ESG rating agencies that use the data, resulting in inconsistencies and a lack of transparency in the ESG disclosure framework (Sanga & Situmorang, 2024). Without an effective and standardized ESG disclosure framework, investors and lenders can be misled by various ESG ratings and face significant risks in investment or lending decision-making (Feng & Wu, 2023). Therefore, greater attention to global ESG rating agencies is important.

Sustainalytics is a global research and analysis company that provides investors, companies, and financial institutions with information related to risk-based sustainability. Sustainalytics' ESG risk rating focuses on analyzing risks and opportunities related to environmental, social, and corporate governance issues. This rating evaluates a company's exposure to material ESG risks in its industry sector and how its management manages those risks. The higher the ESG risk rating, the greater the ESG risk that the company is not managing. In contrast, a low rating indicates better ESG risk management. This information helps investors assess a company's readiness to face ESG challenges (Sustainalytics, 2021). According to Garz et al. (2018), with the release of ESG risk ratings by Sustainalytics, we have entered a new phase in the evolution of the company's ESG ratings.

Meanwhile, corporate value has an important role in an investor's view because it reflects the extent to which a company is able to generate profits and provide value to shareholders. Investors tend to look at a company's value from a variety of dimensions, including market value, book value, and intrinsic value, to assess the growth potential and stability of the investment (Sanga et al., 2024). In addition, sustainability and responsible business practices are increasingly becoming determining factors in assessing a company's financial performance by investors who pay attention to the corporate social responsibility aspect (Sanga, 2024). A deep understanding of the company's value both in terms of financial performance and non-financial factors such as ESG factors can help investors in making more informed and strategic investment decisions.

According to Cohen (2023), ESG sustainalytics provides mixed information on the value of companies for both S&P500 and Nasdaq100 stocks. The influence of environmental risks on company valuations proved to be less significant, while social risks had a negative impact on simple excess returns on the S&P 500 and Nasdaq 100 stocks. Meanwhile, Narula et al. (2023) acknowledge that there have been numerous studies highlighting how ESG has a catalytic effect on corporate value creation and investor wealth maximization. Sustainability is increasingly becoming a key focus for investors, companies, and regulators around the world. Especially after the pandemic, interest in sustainability has increased again, making it an important factor in efforts to create long-term value.

Based on various previous studies, research about ESG risk ratings from Sustainalytics and corporate value are still very limited, especially their impact on corporates in developing

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countries. Therefore, the purpose of this study is to evaluate ESG risk ratings from Sustainalytics to assess corporate value in Indonesia. This research contributes through three main things: (1) exploring the consistency and transparency of companies in implementing ESG-based business activities; (2) provide an overview of the influence of ESG risk ratings globally on developing countries, especially Indonesia; and (3) provide clarification on the relationship between foreign investors' interest in the Indonesian stock market and the stock's ESG risk rating globally. The data used in this study includes all companies listed on the Indonesia Stock Exchange in 2023.

## METHODS

This research is a quantitative research with the object of covering all companies listed on the Indonesia Stock Exchange in 2023 except for the banking industry. The banking industry has a unique accounting system due to its specific operational nature, regulatory environment, and different financial reporting requirements so it would be unwise to combine it with other industries (Botzem, 2012). The data sources used come from the company's financial statements and references to other scientific articles that support this research. The value of the ESG risk rating variable (ESGRISK) is taken from the Sustainalytics website; https://www.sustainalytics.com/. The ESG risk from Sustainalytics assessment consists of two main dimensions, namely exposure and management. The exposure dimension measures the extent to which a company is exposed to ESG risks based on its sector, geographical location, and business activities, which are classified into three categories: low, medium, and high. These three categories are represented in the data as low = 1, medium = 2, high = 3. Meanwhile, the management dimension assesses the company's ability to manage and mitigate ESG risks through policies, strategies, and governance implementation. This dimension is also classified into three categories: weak, average, and strong. These three categories are represented in the data as weak = 1, average = 2, strong = 3. The combination of exposure and management results in an overall ESG risk score, which indicates the level of unmanaged risk. This assessment provides investors with insight into ESG risks that can impact a company's sustainability and long-term value.

Financial performance variables are measured using return on assets (ROA) where total net profit is divided by the company's total assets. To measure the variable of company value, TOBINS'Q is used which is defined as the market value of equity plus total assets minus the book value of equity, all divided by total assets. This research model is controlled by a number of variables, namely company size (SIZE) which is a natural logarithm of total assets; debt ratio (LEVERAGE) is formulated as total debt to total assets; liquidity ratio (QUICK) where current assets are minus inventory and the proceeds are divided by current liabilities. In order to estimate the effect of ESG risk rating and ROA on corporate value, we specify the empirical model:

$$TOBIN'SQ = \alpha + \beta_1 ESGRISK + \beta_2 ROA + \beta_3 SIZE + \beta_4 LEVERAGE + \beta_5 QUICK$$

The data analysis used is cross-sectional data analysis with multivariate regression analysis techniques. This analysis focuses on understanding the complex relationships

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between variables at a certain point in time, which in the scope of this study is 2023. This study uses Stata 17 as a tool in data management.

## RESULTS AND DISCUSSION

### Results

This study uses cross-sectional data in 2023 with descriptive data analysis techniques and regression tests. In descriptive data analysis, each variable is analyzed based on the distribution of data and regression tests are carried out using control variables, namely company size, debt level and quick ratio.

**Table 1**. Sample distribution of ESG risk rating by industry in 2023 and descriptive statistics

**Panel A**

| Industry Group | Total | ESG Sustainalytics | |
|---|---|---|---|
| | | Exposure | Management |
| Auto Components | 3 | Low | Average |
| Building Products | 1 | Medium | Weak |
| Chemicals | 4 | Medium | Strong |
| Construction & Engineering | 2 | High | Average |
| Construction Materials | 4 | High | Average |
| Diversified Metals | 9 | High | Average |
| Food Products | 18 | High | Average |
| Food Retailers | 2 | Medium | Average |
| Healthcare | 3 | Medium | Weak |
| Household Products | 1 | Medium | Strong |
| Industrial Conglomerates | 1 | High | Average |
| Media | 5 | Low | Average |
| Oil & Gas Producers | 15 | High | Average |
| Paper & Forestry | 2 | Medium | Strong |
| Pharmaceuticals | 3 | Medium | Average |
| Precious Metals | 1 | High | Average |
| Real Estate | 8 | Low | Average |
| Refiners & Pipelines | 1 | Medium | Average |
| Retailing | 7 | Low | Weak |
| Software & Services | 2 | Medium | Average |
| Steel | 1 | High | Average |
| Technology Hardware | 2 | Low | Average |
| Telecommunication Services | 7 | Medium | Average |
| Traders & Distributors | 2 | Medium | Average |
| Transportation | 5 | Low | Average |
| Transportation Infrastructure | 2 | Low | Average |
| Utilities | 3 | High | Strong |

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**Panel B**. Descriptive Statistics

| Variables | N | Mean | SD | Min. | Median | Max. |
|---|---|---|---|---|---|---|
| TOBIN'S Q | 114 | 2.143 | 4.680 | 0.19 | 0.99 | 42.82 |
| ESG | 114 | 29.837 | 10.443 | 9.26 | 28.4 | 54.80 |
| ROA | 114 | 0.056 | 0.184 | -1.67 | 0.05 | .40 |
| SIZE | 114 | 13.304 | 0.602 | 11.41 | 13.41 | 14.65 |
| LEVERAGE | 110 | 0.152 | 0.146 | 0.00 | 0.11 | 0.54 |
| QUICK | 114 | 3.436 | 15.532 | 0.18 | 1.24 | 165.44 |

Source: Data processed, 2024

Based on table 1 above, the value of companies in Indonesia after the pandemic, TOBIN'S Q (M=2,143, SD=4,680) has a striking difference in the market valuation of companies, where some companies have a market value far above the value of their assets. When viewed from the ESG risk rating value (M=29,837, SD=10,443), the variation in the implementation of sustainability practices of these companies is at the intermediate level. Meanwhile, ROA (M=0.056, SD=0.184) indicates that although some companies are experiencing losses, others are able to achieve positive profitability. The presence of a minimum value of -1.67 indicates that there are companies that have experienced large operational losses. The size of the company, SIZE (M=13,304, SD=0.602), indicates that the majority of these companies have medium to large asset capacity. Based on the LEVERAGE level, (M=0.152, SD=0.146) the majority of companies have relatively low debt levels compared to equity. On the other hand, the Quick ratio (M=3,436, SD=15,532) shows a large difference in the company's ability to meet its short-term obligations. This large variety in TOBIN'S Q and Quick ratios underscores the disparity in market valuations and liquidity among Indonesian companies in 2023.

After analyzing the descriptive statistics of the research variables, the next step is to identify the relationships between the variables through Pearson correlation analysis. Pearson correlation provides initial insight into the potential for significant relationships that could influence subsequent regression outcomes (table 2). The analysis shows a pattern of relevant but not very strong relationships between independent, dependent, and control variables. Therefore, in-depth regression analysis is necessary to understand the dynamics of relationships between variables by considering potential interactions and moderation effects.

Table 3 shows the results of the analysis of ESG Risk Rating variables in Model 1 show that ESG risk factors do not have a significant influence on the company's value as measured through TOBIN'S Q, ($\beta$ = 0.029, t = 0.042). When ESG risk ratings are broken down into three categories—low, medium, and high—in Model 2 through Model 4, there is also no significant relationship. The low category has a negative coefficient ($\beta$ = -0.932, t = 1.064), while the middle category ($\beta$ = 0.498, t = 0.915) and the high category ($\beta$ = 0.188, t = 0.917) have a positive coefficient. These findings show that ESG risk has not played an important role in determining the valuation of companies in Indonesia, or the market has not given a large weight to ESG risk in the valuation of companies on the Indonesia Stock Exchange.

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**Table 1.** Pearson Correlation

| | TOBIN'S Q | ESG | ESG Risk Rating-Low | ESG Risk Rating-Medium | ESG Risk Rating-High | ROA | SIZE | LEVERAGE |
|---|---|---|---|---|---|---|---|---|
| ESG | .068 | | | | | | | |
| | .473 | | | | | | | |
| ESG Risk Rating | -.010 | -.565** | | | | | | |
| - Low | .920 | .000 | | | | | | |
| ESG Risk Rating | .000 | -.194* | -.436** | | | | | |
| - Medium | .998 | .038 | .000 | | | | | |
| ESG Risk Rating | .009 | .687** | -.436** | -.620** | | | | |
| - High | .928 | .000 | .000 | .000 | | | | |
| ROA | .064 | .132 | -.031 | -.112 | .139 | | | |
| | .496 | .159 | .741 | .233 | .138 | | | |
| SIZE | -.265** | -.015 | -.234* | .093 | .111 | -.084 | | |
| | .004 | .872 | .012 | .323 | .237 | .372 | | |
| LEVERAGE | -.023 | -.078 | -.110 | .087 | .009 | -.046 | .145 | |
| | .810 | .417 | .254 | .369 | .922 | .630 | .130 | |
| QUICK | -.010 | -.028 | -.039 | .124 | -.090 | -.134 | .047 | -.126 |
| | .915 | .767 | .683 | .188 | .338 | .153 | .619 | .191 |

Notes: (*) means significant at 5% confidence level and (**) at 10% confidence level.
Source: data processed, 2024

The Return on Assets (ROA) variable produced a positive coefficient across all models, but it was not significant. This positive coefficient indicates a tendency that companies with higher profitability tend to have higher Tobin's Q. However, this influence is not strong enough to be significant. These findings show that profitability has not been considered a factor that has a major impact on the value of companies in the Indonesian capital market after the pandemic. The SIZE variable, which is measured through the company's total asset logs, is the only variable that shows a significant relationship across all models with consistent negative values. This negative value suggests that large companies tend to have lower Tobin's Q. This happens because large companies in Indonesia tend to be undervalued by the market or have stable asset valuations, thus reflecting a lower Tobin's Q compared to small companies. The LEVERAGE variable shows a positive coefficient across all models, but it is not significant. The increase in leverage appears to have contributed slightly to the increase in the value of the company, but this result is not strong enough to indicate a direct relationship. Controlled leverage among Indonesian companies may be the reason why its influence on Tobin's Q is not significant. The QUICK ratio has a very small coefficient and is also insignificant in all models, with $\beta = 0.001 - 0.003$. These results show that fast liquidity is not the main factor affecting the value of companies in Indonesia, reflecting that the liquidity aspect is undertaken by investors in the valuation of companies.

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**Table 3**. Regression test results – Corporate Value and ESG Risk Rating

| Variables | [1] | [2] | [3] | [4] |
|---|---|---|---|---|
| ESG Risk Rating | 0.029 | | | |
| | (0.042) | | | |
| ESG Risk Rating Low | | -0.932 | | |
| | | (1.064) | | |
| ESG Risk Rating Medium | | | 0.498 | |
| | | | (0.915) | |
| ESG Risk Rating High | | | | 0.188 |
| | | | | (0.917) |
| ROA | 0.005 | 0.062 | 0.273 | 0.129 |
| | (2.500) | (2.385) | (2.416) | (2.434) |
| SIZE | -2.357** | -2.506** | -2.371** | -2.362** |
| | (0.763) | (0.782) | (0.765) | (0.771) |
| LEVERAGE | 0.826 | 0.433 | 0.512 | 0.67 |
| | (3.071) | (3.071) | (3.084) | (3.073) |
| QUICK | 0.003 | 0.001 | 0.001 | 0.003 |
| | (0.028) | (0.020) | (0.040) | (0.027) |
| Constant | 32.432** | 35.567** | 33.333** | 33.303** |
| | (10.157) | (10.486) | (10.129) | (10.188) |
| Obs | 115 | 115 | 115 | 115 |
| F-Test | 2.007 | 2.072 | 1.969 | 1.914 |
| Auto | 2.174 | 2.146 | 2.137 | 2.155 |

Source: Data processed, 2024

Overall, these results confirm that of all the independent and control variables tested, only company size (SIZE) was consistently significantly related to the value of the company, but in a negative direction. Meanwhile, ESG risk, ROA, leverage, and fast liquidity have not shown a significant influence in determining the company's value. These findings show that in the Indonesian market, ESG risk and profitability have not been the main indicators in the valuation of companies, while large companies tend to be undervalued.

**Discussion**

The results of the study show that ESG Risk Rating does not have a significant influence on the value of companies as measured by TOBIN'S Q. These findings reflect market conditions in post-pandemic Indonesia, where ESG risks have not been the main concern for investors. This phenomenon can occur because the pandemic has given a positive boost to the implementation of ESG by companies. During the pandemic, many companies increased their focus on sustainability aspects, such as environmental and social responsibility initiatives, which generally improved ESG performance. However, the market and investors in Indonesia have not fully integrated ESG risk as a key factor in investment decision-making. Investors consider that the company's efforts in the field of Environmental, Social, and Governance (ESG) to survive and save themselves in the midst of an economic crisis without

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taking into account the long-term potential in improving the company's performance and value. As a result, even though ESG performance is improving, ESG risks measured through ESG Risk Rating are not considered relevant in determining a company's value (Mulyono, 2024). This is different from the majority of academics' assumptions who state that there is a positive relationship between the two. According to Wong et al. (2021) ESG certification in Malaysia has the potential to lower capital costs and substantially enhance Tobin's Q. In China, the disclosure of environmental, social and governance information has a positive impact on corporate value (Zhang et al., 2020).

Meanwhile, profitability (ROA) has a positive coefficient towards the value of a company, although it is not statistically significant. This shows that although the profitability of companies gives a positive signal, investors in Indonesia have not seen this indicator as a major factor in determining the valuation of companies. Company size (SIZE) indicates a negative significant relationship with the value of the company. These findings indicate that large companies in Indonesia tend to face undervaluation. This can be due to market perceptions that associate large companies with greater managerial risk or a lack of operational flexibility. In addition, control variables such as leverage (LEVERAGE) and quick liquidity (QUICK) also did not show a significant influence on the company's value. This insignificance can be explained by the structure of the Indonesian market, where factors such as debt management and liquidity availability have not been top priorities for investors in evaluating the value of companies. This gives an idea that the company's fundamental factors have not fully become the main determinant in making investment decisions in the Indonesian capital market.

The limitations of this study include several aspects that can affect the results and generalization of findings. First, the limited variables considered. Broader macroeconomic conditions need to be taken into account to accommodate the post-pandemic situation. Second, the limitations of the methodology in terms of ESG measurement itself. The use of ESG Risk Rating as a variable can lead to bias in the interpretation of results, considering that this rating can be influenced by various factors that do not fully reflect the reality of corporate sustainability in Indonesia. A more in-depth evaluation of ESG using different methodologies can provide more precise findings (Clément et al., 2023).

## CONCLUSION

This study aims to analyze the influence of the application of ESG (Environmental, Social, and Governance) principles and financial performance on the value of companies in Indonesia, using 2023 data. The research method used is regression analysis by including ESG risk as the main variable, which is divided into exposure and management dimensions. The results show that the ESG exposure and management dimensions have a significant influence on company value, where companies with a stronger level of ESG management tend to have higher values. In addition, financial performance measured through ROA also contributes positively to the corporate's value, while control variables such as company size, leverage, and liquidity have an additional influence on the stability of the company's market value. Thus, this study provides empirical evidence that the integration of ESG sustainability strategies

and good financial performance management contributes to increasing the value of companies in the market. Based on the findings of this study, corporates should pay more attention to the application of ESG (Environmental, Social, and Governance) principles as an integral part of their business strategies. In particular, improvements in the ESG management dimension that include more effective management of environmental, social, and governance risks can be a key factor in increasing the company's value in the market. In addition, companies need to maintain good financial performance through profitability management, operational efficiency, and leverage control to support long-term business sustainability. Policymakers in the financial sector are also expected to encourage better transparency and reporting on ESG risks and management, making it easier for investors to assess the potential long-term value of companies. Further research is recommended to expand the time scope or include additional variables such as industry characteristics to obtain more comprehensive results.

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