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THE IMPACT OF ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG) ON RETURN ON ASSETS (ROA)
(Cross-Country Evidence of the Energy Sector in 2019-2021)

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ABSTRACT

The purpose of this study is to examine how Environmental, Social, and Governance Disclosure affects business profitability. Three factors, including the environmental (ENVDiscI), social (SOCDiscI), and corporate governance (GOVDiscI) Disclosures components, are used to assess ESG disclosure. Meanwhile, Return on Assets serves as a proxy for the company's financial performance (ROA). Financial Leverage (FL) and Asset Turnover (AT) are two additional control variables used in this study.

A total of 140 companies consists of energy sector enterprises in Indonesia, Germany, Finland, the United States, Brazil, India, and South Africa made up the sample for this study, which employed purposive sampling and secondary data from Bloomberg Database. Multiple linear regression analysis is used in this study's analysis, and IBM SPSS Statistics 25 is used to handle the data.

The results suggest a significant correlation between a company's disclosure practices and its ROA. Specifically, ENVDiscI and SOCDiscI demonstrated a positive and significant impact on ROA, whereas GOVDiscI negatively influenced ROA. These results suggest that prioritizing environmental and social disclosures can potentially enhance a company's Return on Assets, while an excessive emphasis on governance disclosures may be counterproductive. This study's findings underline the crucial role transparency in environmental and social practices can play in driving a company's profitability, emphasizing the need for more comprehensive ESG disclosures in shaping industry best practices.

Keywords: ESG Disclosure, Environmental Disclosure, Social Disclosure, Governance Disclosure, and Return on Assets

INTRODUCTION

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Environmental, Social, and Governance (ESG) growth has been predominantly driven by environmental concerns and climate change mitigation efforts. In parallel, the social component of ESG has garnered increasing attention. Research demonstrates a notable 37% surge in shareholder proposals pertaining to social issues during the 2021 proxy season compared to the previous year (Vanderford, 2022). ESG, a framework employed to assess a firm's sustainability, is extensively applied in developed countries. However, its application in developing nations remains understudied. Evidently, ESG information disclosure in sustainability reports can potentially augment a company's performance.

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Prior studies have revealed a mixture of positive and negative effects of ESG and its individual components on a company's financial outcomes. Alareeni and Hamdan (2020) discovered a correlation between comprehensive ESG disclosure and company performance. Choongo (2017) argues that the Environmental Disclosure Score positively influences the financial performance of companies in Zambia, a sentiment echoed by Haninum (2018) for Japanese companies. In contrast, certain studies (Akben Selcuk & Kiymaz, 2017; Walker et al., 2019) have illustrated the detrimental impact of environmental disclosure on financial performance, particularly on the Return on Assets (ROA).

Subsequent research has pivoted towards the Corporate Social Responsibility (CSR) Disclosure component, with findings showing that companies high in CSR disclosure often have superior financial performance (Kakanda et al., 2017; Choongo, 2017). Contrarily, Baalouch et al., (2019) found that Social Disclosure can negatively affect a company's ROA. Governance Disclosure studies, like the ones by Albitar et al., (2020) and Baalouch et al., (2019), have pointed towards a positive influence on a company's ROA. However, Farooq et al., (2015) suggested that a larger board size can impair financial performance.

Given these diverse findings, this study aims to further examine how ESG disclosure impacts business profitability, particularly in the context of energy sector enterprises across different countries. Understanding the complex relationship between ESG components and financial performance can help shape future business and sustainability practices.

THEORETICAL FRAMEWORK AND HYPOTHESIS DEVELOPMENT

Pecking Order Theory

The pecking order theory has been the subject of extensive recent empirical studies on capital structure, although the findings are still inconsistent. Some empirical studies have been validated, while others have not. The pecking order hypothesis is shown to have good support by Shyam-Sunder and Myers (1999), however, it has limited support by Frank & Goyal (2003).

Based on the asymmetric information between managers and investors, the pecking order theory by Myers & Majluf (1984) and Myers (1984) and its extension (Lucas and McDonald, 1990) were studied. Compared to outside investors, managers are more informed about the underlying worth of the company and its risks. Myers (1984) asserts that businesses, if possible, use retained earnings to fund their operations. Debt is utilized if the return earnings are insufficient. Firms won't employ fresh equity financing until in dire circumstances. Thus, internal money from earnings was the first financial source employed, followed by short-term securities, debt, preferred stock, and finally common stock. According to the pecking order principle, issuing equity (common stock) will be the final available source of finance.

Stakeholder Theory

Diverging from the Pecking Order Theory, The Stakeholder Theory which emphasizes the diverse groups that shape and are shaped by a company's actions. These stakeholders can range from employees and shareholders to suppliers, government bodies, and beyond. The theory, first introduced by the Stanford Research Institute in 1963, presents a series of propositions suggesting that corporate managers have obligations

beyond purely economic interests, extending to the interests of all stakeholders. These obligations become particularly important in the context of ESG disclosures, where transparency can impact multiple stakeholders.

The implementation of the Stakeholder Theory can be viewed through three levels of analysis (Freeman, 2010). The first level, the rational level, focuses on a business strategy that necessitates an accurate understanding of the larger business context by identifying relevant groups and understanding the nature of the company-stakeholder relationships. This perspective is invaluable when assessing the impact of ESG disclosures on the business profitability and its wider stakeholder community.

The Impact of Environmental Disclosure on Company Return on Assets (ROA)

The relationship between environmental concerns, notably climate change and global warming, and Return on Assets is a subject of ongoing debate. These critical environmental issues carry potential implications for not only future business prosperity but also global health. As public awareness of these issues increases, companies are urged to establish environmental policies and provide transparent reporting on their commitments to this cause. Wagner & Schaltegger (2004) discovered that firms with environmental policies typically exhibit a more positive relationship with ROA than those without. Further supporting this, studies by Murray et al. (2006) and Ong et al. (2014) also identified a positive relationship between environmental performance and ROA. This leads to the formulation of the first hypothesis:

H1: Environmental Disclosure has a positive influence on ROA

The Impact of Social Disclosure on Company Return on Assets (ROA)

Social Disclosure provides information on the company's social performance as a form of accountability. By reporting this, the company can gain the trust of related parties and give a good reputation to the company name. According to Sameer (2021) practicing corporate social responsibility can improve the performance of the company.

Meanwhile, several studies conducted by, Pyo & Lee (2013) also state that corporate social responsibility can help companies increase long-term profits and help the sustainability of a company. These results are also consistent with the findings of Choongo (2017) and Anser *et al.* (2018) which also show a positive relationship between the two variables. So based on the description can be formulated the following hypothesis.

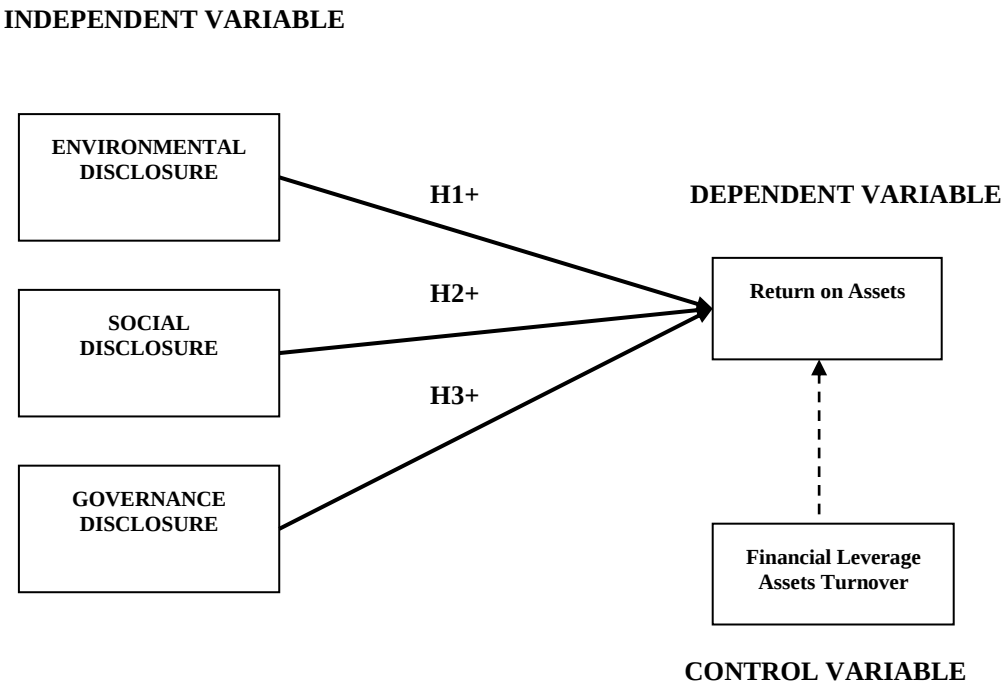
H2: Social Disclosure has a positive influence on ROA

The Impact of Social Disclosure on Company Return on Assets (ROA)

Governance Disclosure covers the processes, structures, and systems through which a company is managed. To gain the trust of stakeholders, companies must be accountable for their management actions, demonstrating transparency about past decisions, current position, and future plans. This links back to corporate social responsibility and sustainability theory, positing that businesses owe it to their stakeholders to provide a clear business strategy framework. Studies by Kakanda (2017), Saini & Singhania (2018), and Enache & Hussainey (2020) all discovered a significant positive relationship between corporate governance and company performance. This brings us to the final hypothesis:

H3: Governance Disclosure has a positive influence on ROA

Figure 1
Theoretical Conceptual Framework



Source**:** Bhuyan & Perera (2017), Choongo (2017), Anser *et al.*, (2018), Haninun (2018), Baalouch *et al.*, (2019), Akben Selcuk & Kiymaz (2017), Walker *et al.*, (2019), Abdullah *et al.*, (2020), Malarvizhi (2016), Nor *et al.*, (2016), Kakanda *et al.*, (2017), Saini & Singhania (2018), Enache & Hussainey (2020), Salleh *et al.*, (2019), Buallay *et al.*, (2017), Albitar *et al.*, (2020), Aboud & Diab (2018), Farooq *et al.*, (2015), Atan *et al.*, (2018)

RESEARCH METHODOLOGY

Research Variables

The dependent variable in this study is Return on Assets (ROA) as a proxy for measuring a company's financial performance. The independent variables in this study are the Environmental Disclosure Score, Social Disclosure Score, and Corporate Governance Disclosure Score. The study used control variables, including Asset Turnover (AT) and Financial Leverage (FL).

Population and Sample

To make an encompassing inclusive cross-country analysis research, these selected countries (Indonesia, Germany, Finland, the United States, Brazil, India, and South Africa) would be the objects for the study. The selection of the objects is also specified by the net-zero targets of these countries and representation from regions across the world. The population used in this study is the energy sector company within the selected countries for 2019-2021 period with a note that not all populations will be used as research objects. There are 140 energy sector companies in selected countries that meet the requirements so they are worthy of being sampled in this study.

Data Types and Sources

This study employs quantitative data, which is sourced from secondary data. Secondary data refers to information collected from existing sources such as statistical data, government publications, published or unpublished materials from organizations, company websites, and the internet.

Analysis Method

Data analysis is conducted through the use of multiple linear regression analysis (Ordinary Least Square) for panel data, combining both time-series and cross-sectional data. This analysis is facilitated with IBM SPSS (Statistical Package for the Social Sciences) Statistics version 25 software.

RESULTS AND DISCUSSION

Description of Research Object

Table 1
Research Object

No.	Description	Total
1.	The population of the energy sector in the selected countries in 2019-2021	2765
2.	Sample Criteria	(2595)
	• Indonesia, Germany, Finland, the United States, Brazil, India, and South Africa	
	• Companies with complete data on the Environmental Disclosure Score, Social Disclosure Score, and Governance Disclosure Score in the Bloomberg database in the 2019-2021 period.	
3.	Total Sample	170

Source: Bloomberg database (2022)

Table 1 is the research object used as a research sample after searching for outlier data. The research sample consisted of companies with a total of 323 data observations. The company data in this study were obtained through Bloomberg and the annual financial reports of each company. This research uses the help of the IBM SPSS (Statistical Package for Social Science) Statistics version 25 program.

Descriptive Statistical Analysis

Descriptive statistics are an overview or description of the data that are interpreted through the mean, median, maximum, minimum, the standard deviation of each variable used in the study. Descriptive statistics for each variable are presented in table 2 with a total of 323 data from a sample of companies during 2019-2021 as follows:

Table 2
Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	323	-0.33	0.25	-0.01	0.095
ENVDiscI	323	0.00	78.07	21.4379	21.63102
SOCDiscI	323	2.57	71.86	27.4784	15.84757
GOVDiscI	323	55.84	100.00	85.9682	6.67369
AT	323	0.00	1.58	0.4786	0.32021
FL	323	1.08	18.66	2.2661	1.19598
Valid N (listwise)	323				

Source: IBM SPSS 25 (2023)

The data range between the minimum values and the maximum values for the variables ENVDiscI, SOCDiscI, GOVDiscI, and FL shows that the energy sector companies in the selected countries in 2019-2021 exhibit behavior that differs greatly between companies. Based on table two, it can be seen that the average statistical values of SOCDiscI, GOVDiscI, AT, and FL have an average value that is higher than the standard deviation. This has the meaning that it indicates that the data included is classified as good data and the standard deviation value describes the deviation of the data which has an impact on the distribution of biased data. The ROA and ENVDiscI variables have the average value that is smaller than the standard deviation, this indicates that the variable has a diverse and uneven distribution of data.

Classical Assumption Test

Table 3
Classical Assumption Test

No.	Normality Test – Kolmogorov Smirnov	Multicollinearity Test	Heteroscedasticity Test – Glesjer Test	Autocorrelation Test – Durbin Watson
1	Pass	Pass	Pass	Pass

Source: IBM SPSS 25 (2023)

The following are the results of the classic assumption test in research, including:

1. Normality Test (Kolmogorov Smirnov)
   The results of the Kolmogorov-Smirnov normality test showed that the regression of the residual values of all variables has significant results indicated by the Asymp Sig (2-tailed) significance number which is greater than 0.05. Therefore, it can be concluded that all variables have normally distributed data.
2. Multicollinearity Test
   The results of the multicollinearity test for all independent and control variables have a tolerance value that is greater than 0.10 and a VIF value that is less than 10. So, it can be said that the sample data does not show symptoms of multicollinearity.
3. Heteroscedasticity Test
   Glejser's results in the regression model have a probability value (Sig) of the absolute residual of more than 0.05 for each variable. The results conclude that there are no symptoms of heteroscedasticity in the regression model.
4. Autocorrelation Test

The results of the autocorrelation test on the model show a Durbin-Watson (DW) value of 1.878 which is between 1.699 and 2.301, so based on the results of the autocorrelation test it can be concluded that the regression in the model has no symptoms of autocorrelation.

Discussion of Research Results

Statistical F-Test (Goodness of Fit)

Table 4
Goodness of Fit Test Result (Statistical F-Test)

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.283	5	.057	6.136	.000[b]
	Residual	2.928	317	.009		
	Total	3.211	322			

a Dependent Variable: ROA

b Predictors: (Constant), FL, AT, GOVDiscI, ENVDiscI, SOCDiscI

Source: IBM SPSS 25 (2023)

The F test can be done by looking at the significance probability value (sig F). Based on the results of the F test presented in table four, an F value of 6.136 is obtained with a significance of 0.000. Because the resulting significance value is less than 0.05 (<0.05) it can be concluded that the regression model equation in this study is feasible to use because the independent variables have a simultaneous influence on the dependent variable.

Statistical t-Test (Individual Parameter Significance Test)

Table 5
Individual Parameter Significance Test (Statistical t-Test)

Model		Unstandardized Coefficients		Standardized Coefficients	Sig.
		B	Std. Error	Beta	
1	(Constant)	3.182	.078		.002
	ENVDiscI	3.125	.000	.144	.002
	SOCDiscI	2.184	.000	.101	.029
	GOVDiscI	-2.976	.001	-.149	.003
	AT	2.651	.015	.130	.008
	FL	1.078	.004	.053	.282

a. Dependent Variable: ROA

Desc: sig5%

Source: IBM SPSS 25 (2023)

Results of the First Hypothesis

The results of the parameter significance test in table 5 show that the ENVDiscI variable has a coefficient value of 3.125 with a significance value of 0.002 which can be

seen that the significance value is smaller than 0.05 so it is concluded that there is a significant positive effect between Environmental Disclosure on financial performance which is proxied with Return on Assets which means there is a significant positive influence on the relationship between the ENVDiscI variable and the company's Return on Assets. Therefore, in this study, it can be concluded that **H1 is accepted**.

Results of the Second Hypothesis

The results of the parameter significance test in table 5 show that the SOCDiscI variable has a coefficient value of 2.184 with a significance value of 0.029 which can be seen that the significance value is smaller than 0.05 so it can be concluded that there is a significant positive effect between Social Disclosure on financial performance which is proxied by Return on Assets which means that there is a significant positive influence on the relationship between the SOCDiscI variable and the company's Return on Assets. Therefore, in this study, it can be concluded that **H2 is accepted**.

Results of the Third Hypothesis

Based on the value of the parameter significance test results in table 5, it shows that the GOVDiscI variable has a coefficient value of -2.976 with a significance value of 0.003 which can be seen that the significance value is less than 0.05 so it can be concluded that there is a significant negative effect between Governance Disclosure on financial performance proxied by Return on Assets. These results mean that there is a negative influence on the relationship between the GOVDiscI variable and the company's Return on Assets. Therefore, in this study, it can be concluded that **H3 is rejected**.

Determination Coefficient Test (R^2)

Table 6
Determination Coefficient Test Result

Model	R	R Square	Adjusted R Square	Std. Error the Estimate
1	.297[a]	.088	.074	.096

Source: IBM SPSS 25 (2023)

Based on Table 6, the Adjusted R Square value in the model equation is 7.4%, so this value means that Environmental Disclosure (ENVDiscI), Social Disclosure (SOCDiscI), Governance Disclosure (GOVDiscI), asset turnover (AT), and financial leverage (FL) can explain the variance of the dependent variable, namely Return on Assets of 7.4%.

CONCLUSION

This research was conducted to examine the influence between the dependent variable and the independent variable. The dependent variable used in this research is company performance which is represented by Return on Assets. While the independent variables in this study are disclosure of ENVDiscI, SOCDiscI, and GOVDiscI. The research data used in this study are the energy sector in the selected countries (Indonesia,

Germany, Finland, the United States, Brazil, India, and South Africa) and which have disclosed ESG scores for 3 years, from 2019 to 2021. Data sampling in this study was carried out using a purposive sampling technique which will then be processed. with panel data regression. in SPSS. Based on testing the hypotheses that have been proposed in this study, the conclusions obtained from this study include:

1. Disclosure of ENVDiscI Disclosure variable is proven to have a significant positive effect on company Return on Assets. Then hypothesis 1 is accepted.
2. Disclosure of SOCDiscI Disclosure variable is proven to have a significant positive effect on company Return on Assets. Then hypothesis 2 is accepted.
3. Disclosure of GOVDiscI Disclosure variable is proven to have a significant negative effect on company Return on Assets. Then hypothesis 3 is rejected.

Research Limitations

Based on the research, it was found that the Adjusted R Square value in the regression equation is 7.4%, which means 7.4% of the variation in Return on Assets can be explained by variations of the four independent variables namely ENVDiscI, SOCDiscI, and GOVDiscI. These results indicate that there is 92.6% influence from outside the independent variables in the study that affect the dependent variable of company performance which is proxied by Return on Assets (ROA).

Suggestion

Given the limitations of the present study, it is recommended that future research explore additional variables not covered in this analysis. These could include variables such as firm age (as studied by Saini & Singhania, 2018), Research & Development expenditures (as per Akben Selcuk & Kiymaz, 2017), or other variables related to the disclosure of environmental, social, and corporate governance aspects. Incorporating these additional variables could potentially provide a more comprehensive understanding of the factors affecting a company's financial performance.

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