

The Effect of Environmental, Social, Governance on Financial Distress in Companies Listed on The Idx

Ainur Mutasyah¹, Anwar Hariyono²
^{1,2} Muhammadiyah University of Gresik



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ABSTRACT

General Background: Financial distress is a critical condition that companies experience before bankruptcy or dissolution, making its identification essential to prevent such outcomes. **Specific Background:** In recent years, aspects of Environmental, Social, and Governance (ESG) have gained attention as potential indicators of financial health, particularly in manufacturing companies. **Knowledge Gap:** However, limited research examines how ESG factors influence financial distress, especially in the context of emerging markets like Indonesia. **Aims:** This study investigates the impact of ESG disclosures on financial distress among manufacturing companies listed on the Indonesia Stock Exchange (IDX) during 2019–2022. **Results:** The results indicate that corporate governance disclosure has a significant negative effect on financial distress ($p = 0.008$), whereas environmental and social disclosures do not show a significant impact ($p = 0.342$ and $p = 0.455$, respectively). **Novelty:** This study highlights the distinct role of governance in mitigating financial distress, differentiating it from environmental and social disclosures, which have shown no significant effect. **Implications:** The findings suggest that corporate governance improvements may help companies avoid financial distress, while environmental and social factors may require further investigation for more comprehensive insights.

INTRODUCTION

The economic sector is facing rapid changes due to current business competition. In increasing their profits, companies must develop and advance in order to survive amidst rivalry with other companies. Companies that are not ready to face competition with other companies can face a decline in financial performance which can result in financial constraints or financial distress. This is bad news that the company's financial situation is experiencing a financial crisis that results in the company's bankruptcy. As a result, companies that were previously able to run their businesses well are now faced with potential losses that can lead them to financial distress. This condition refers to the

destruction of the company's financial condition that arises before bankruptcy occurs [1]. According to [2] states that this bankruptcy situation arises when a business faces losses in several years. If businesses can anticipate financial problems early on and take the necessary steps to improve the situation, bankruptcy can be avoided. Companies with declining profit situations can generally be more difficult and may face bankruptcy (liquidation). One way to see the condition of the company is by looking at the financial statements. In assessing financial reports, financial ratios are used to show how good or bad a company's financial condition is, including the level of financial constraints [3].

[4] Stated that current financial reports are considered insufficient to meet shareholder requirements. They said that additional reports such as sustainability and intellectual reports are also needed. because the 3 elements of a sustainability report are environmental, social, and governance, environmental, social, and governance disclosures can help companies and stakeholders because they provide non-financial information about the business that explains its economic, environmental, and social aspects [5].

According to [6] the achievement of a company's goals cannot be separated from the intervention of stakeholders in the entire process. Therefore, stakeholder theory is very important for companies to be able to provide equivalent returns to all their stakeholders by improving company performance. Implementing environmental, social, and governance disclosures through sustainability reports can be one of the most effective ways to improve company performance. That way, stakeholders will have the view that the company really pays attention to environmental sustainability and the interests of their stakeholders very well [1].

Another theory that supports environmental, social, and governance is agency theory. The misalignment of interests between agents (management) and principals (shareholders) can trigger conflicts of interest, information asymmetry, and agency conflict. In this case, an environmental, social, and governance order is needed that can act as a control mechanism between parties. The environment, social, and governance in a company will determine the direction and objectives of the company through the duties and functions of each organ within it. The environmental, social, and governance mechanism requires transparency in exercising control over the company as authorized by the principal. Transparency can reduce information asymmetry. The form of transparency is realized through the company's annual report which provides an overview of the implementation of the environment, social, and governance and the company's financial condition [7].

There is also a previous research gap in indicating the environment, social, and governance on financial distress, namely research conducted by [8] which states that the environment, social, and governance have a significant positive effect on financial distress, this research is in line with research conducted [9] However, this is not in line with research conducted by [10] which states that the environment, social, and governance do not have a significant effect on financial distress but is not in line with research conducted by [7] which found that environmental, social, and governance disclosures have an impact on financial distress. On the other hand [11] found that

environmental, social, and governance disclosures have a significant negative effect on financial distress.

Based on the research gap, the results show inconsistency in research results on environment, social, and governance towards financial distress. This study will answer the gap in previous research related to the influence of environment, social, and governance towards financial distress by using the latest method, namely environmental disclosure is operationalized by comparing 34 environmental performance indicators listed in the Global Reporting Initiative Guidelines (GRI-G4) and social disclosure is analyzed using the Global Reporting Initiative Guidelines (GRI-G4) by comparing 91 indicator items.

This research was conducted by looking at previous research that examined manufacturing companies that had significant results, therefore the researcher was interested in raising this title with the aim of knowing the importance of environmental, social, and governance disclosures on the sustainability of the company's business because of its influence in minimizing the potential for financial distress.

RESEARCH METHOD

This research on financial distress adopts a quantitative approach. The dependent variable in this study is Financial Distress, while the independent variables are Environmental, Social, and Governance. This study was conducted at the Indonesia Stock Exchange (IDX), which released its financial reports for the period 2019–2022 focusing on manufacturing companies in various industries. The information used can be downloaded from the official IDX website (www.idx.co.id). The type of data in this study uses secondary data found through content analysis of sustainability reports and financial reports of manufacturing sector companies listed on the Indonesia Stock Exchange (IDX) for the period 2019–2022. The data collection technique in this study was carried out using the documentation technique. the number of manufacturing companies listed on the Indonesia Stock Exchange (IDX) in the 2019-2022 period is 40 companies. However, there are criteria that have been set, so that only 12 companies can be used as research objects because they meet the established criteria. The observation year was 4 years and 41 data were obtained. In this study, sample determination was carried out using the purposive sampling method. Sample determination is based on several provisions below:

1. Manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the period 2019-2022.
2. Companies that publish financial reports for the period 2019-2022.
3. Companies that publish environmental, social, and governance value reports for the period 2019-2022.
4. Companies that prepare financial reports in Rupiah.

RESULTS AND DISCUSSION

RESULTS

Descriptive Statistics

The results of the data analysis on each research variable can be seen from the following table:

Table 1. Descriptive Statistics Results

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
Y	41	1227.00	20176.00	5540.7805	3254.51113
X1	41	29.00	559.00	188.6341	122.68858
X2	41	55.00	407.00	137.0976	79.13495
X3	41	2.00	3.00	2.9512	.21808
Valid N (listwise)	41				

Source of table data reference: SPSS Output Results 2024

Based on table 1 above, information is obtained related to the general description of research data with a research sample of 41 data. The information that can be presented is as follows:

1. The dependent variable Y, namely financial distress, is known to have a maximum value of 20176.00 and a minimum value of 1227.00. While the mean or average value is 5540.7805 with a standard deviation value of 3254.51113.
2. The independent variable X1, namely environmental disclosure, gets a maximum value of 559.00 and a minimum value of 29.00. While the mean or average value is 188.6341 with a standard deviation value of 122.68858.
3. The independent variable X2, namely social disclosure, gets a maximum value of 407.00 and a minimum value of 55.00. Meanwhile, the mean or average value is 137.0976 with a standard deviation value of 79.13495.
4. The independent variable X3, namely governance disclosure, gets a maximum value of 3.00 and a minimum value of 2.00. Meanwhile, the mean or average value is 2.9512 with a standard deviation value of 0.21808.

Normality Test

In this study, the Kolmogorov-Smirnov (K-S) non-parametric statistical test was used. The data sample in this study was 41 data.

**Table 2. Kolmogorov-Smirnov
 One-Sample Kolmogorov-Smirnov Test**

		Unstandardized Residual
N		41
Normal Parameters ^{a,b}	Mean	.0000000
	Std. Deviation	2888.80688940
Most Extreme Differences	Absolute	.115
	Positive	.115
	Negative	-.069
Test Statistic		.115
Asymp. Sig. (2-tailed)		.194 ^c

- a. Test distribution is Normal.
- b. Calculated from data.
- c. Lilliefors Significance Correction.

Source of table data reference: SPSS Output Results 2024

Based on table 2, it can be concluded that the data used in this study have been distributed normally. This can be seen from the results of the nonparametric one-sample Kolmogorov-Smirnov statistical test which obtained an Asymp.Sig (2 tailed) value greater than 0.05 where in this study the Asymp.Sig (2 tailed) value was obtained at 0.194.

Multicollinearity Test

In determining whether there is a correlation or not, it can be seen through the Tolerance value and the Variance Inflation Factor or VIF value. A good regression model that is free from multicollinearity if the Tolerance value exceeds 0.1 and the VIF value is less than 10 (Ghozali, 2016:106). The table below shows the results of the multicollinearity test:

Table 3. Multicollinearity Test Results Coefficients

Coefficients^a

Model		Collinearity Statistics	
		Tolerance	VIF
1	X1	.319	3.134
	X2	.323	3.099
	X3	.973	1.028

- a. Dependent Variable: Y

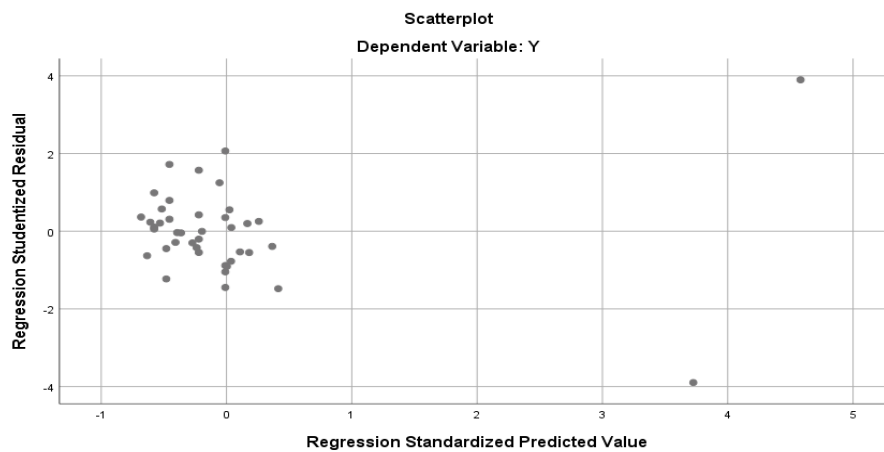
Source of table data reference: SPSS Output Results 2024

Looking at the test results of the multicollinearity test in table 3 above, it can be concluded that all independent variables have a Tolerance value of more than 0.1 and a Variance Inflation Factor or VIF value of less than 10. From the results that have been listed, the regression model research used in this study is free and there is no multicollinearity.

Heteroscedasticity Test

The heteroscedasticity test in this study was conducted by looking at the scatterplot graph, namely between the predicted value of the dependent variable and its residual (Ghozali, 2016). The results of the heteroscedasticity test with the scatterplot graph can be seen below:

Figure 1. Heteroscedasticity Test Results



From the results obtained in the heteroscedasticity test displayed in Figure 1, it can be seen that the scatterplot graphic image pattern displays a randomly distributed pattern above and below the number 0 on the Y axis, so it can be interpreted that this study does not have heteroscedasticity.

Autocorrelation Test

The presence or absence of autocorrelation can be detected by a measuring instrument, namely the Durbin Watson (DW) test by comparing the Durbin Watson results with the results in the Durbin Watson table. The following shows the results of the autocorrelation test:

Table 4. Autocorrelation Test Results

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.461 ^a	.212	.148	3003.63838	1.733

a. Predictors: (Constant), X3, X2, X1

b. Dependent Variable: Y

Source of table data reference: SPSS Output Results 2024

Based on the results obtained, it can be concluded that the data does not have any autocorrelation. This is because the value of $DU < DW < 4-DU = 1.6603 < 1.733 < 2.3397$.

Multiple Linear Regression Test

Multiple linear regression analysis was conducted to test whether there is an Influence of Environmental, Social, Governance on Financial Distress (Ghozali, 2016). The table below shows the results of the multiple linear regression test:

Table 5. Multiple Linear Regression Test Results
Coefficients^a

Model		Unstandardized Coefficients		Standardized	t	Sig.
		B	Std. Error	Coefficients		
1	(Constant)	23970.328	6556.418		3.656	.001
	X1	-6.596	6.852	-.249	-.963	.342
	X2	7.984	10.565	.194	.756	.455
	X3	-6193.992	2207.688	-.415	-2.806	.008

a. Dependent Variable: Y

Source of table data reference: SPSS Output Results 2024

Based on table 5 above, the multiple linear regression equation is as follows:

$$\text{Financial Distress} = 23970.328 - (-6.596)ED + 7.984SD - (-6193.992 GD) + e$$

t-Test

Hypothesis testing is also intended to see the influence and significance of each independent variable on the dependent variable. The first thing to do is to determine the hypothesis formulation, the hypothesis formulation in this study is:

Table 6. Partial t-Test Results
Coefficients^a

Model		Unstandardized Coefficients		Standardized	t	Sig.
		B	Std. Error	Coefficients		
1	(Constant)	23970.328	6556.418		3.656	.001
	X1	-6.596	6.852	-.249	-.963	.342
	X2	7.984	10.565	.194	.756	.455
	X3	-6193.992	2207.688	-.415	-2.806	.008

a. Dependent Variable: Y

Source of table data reference: SPSS Output Results 2024

Based on the data displayed in the table above, it can be seen that the probability value of significance for Environmental Disclosure (X1) is 0.342, which is more than 0.05 according to the provisions. So it is concluded that H1 is rejected and H0 is accepted. This means that partially, the variable X1 Environmental Disclosure does not have a significant effect on the variable Y, namely Financial Distress.

Then for the probability value of the significance of Social Disclosure (X2) is 0.455, which is more than 0.05 according to the provisions. So it is concluded that H2 is rejected and H0 is accepted. This means that partially, the variable X2 Social Disclosure does not have a significant effect on the variable Y, namely Financial Distress.

While for the probability value of the significance of Governance Disclosure (X3) is 0.008, which is less than 0.05 according to the provisions. So it is concluded that H3 is accepted and H0 is rejected. This means that partially, the variable X3 Governance Disclosure has a significant negative effect on the variable Y, namely Financial Distress.

Coefficient of Determination (R²)

The coefficient of determination (R²) is useful for estimating the level of model competence when presenting various independent variables. The results of the coefficient of determination are shown below:

Table 7. Results of Determination Coefficient Test

Model Summary^b				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.461 ^a	.212	.148	3003.63838

a. Predictors: (Constant), X3, X2, X1

b. Dependent Variable: Y

Source of table data reference: SPSS Output Results 2024

The results in table 7 shown above can be seen that the coefficient of determination (Adjusted R Square) is 0.148 in manufacturing companies listed on the IDX or Indonesia Stock Exchange for the period 2019 to 2022. So it can be concluded that the influence of the X or independent variables, namely environmental, social, governance on the Y or dependent variables can be explained in this equation model, namely 0.148 or 14.8% and for the remaining 85.2% financial distress is influenced by other factors that are not used in the regression model of this study.

DISCUSSION

The Influence of Environmental Disclosure on Financial Distress

The results of this research indicate that Environmental Disclosure has no effect on Financial Distress. This shows that in this study the Environment Disclosure variable was not able to be a factor that influenced Financial Distress. This can be seen in the SPSS test results, which show that the Environment Disclosure variable has a significant value greater than 0.05, namely ($0.342 > 0.05$). Based on agency theory, it is explained that Environmental Disclosure in practice emphasizes the importance of transparency in company management which is relevant to the authority given by the principal. Apart from that, stakeholder theory describes how companies can fulfill all stakeholder rights as an effort to manage and maintain relationships with stakeholders. This research obtained results that are contradictory to the theory that has been described. The large proportion in Environmental Disclosure does not mean a decline in the company's financial condition.

The results of this research are not consistent with the findings of [8] and [9], which state that environmental disclosure has a significant positive influence on Financial Distress. With a significance value of 0.342 which is much greater than 0.05, this research shows that Environmental Disclosure transparency does not directly influence Financial Distress.

The Effect of Social Disclosure on Financial Distress

Social disclosure or Corporate Social Responsibility (CSR) plays an important role in carrying out company operations morally and contributing to the progress of society. According to [12]. Corporate Social Responsibility aims to improve the quality of life of employees, their families, and local communities and the public as a whole. This view emphasizes the importance of corporate responsibility in paying attention to its impact on various stakeholders, including employees, local communities and the environment. This is in accordance with stakeholder theory where stakeholders here are not only investors and creditors, but also include the community, government, suppliers and the environment. This research obtained results that are contradictory to the theory that has been described. The large proportion of Social Disclosure does not mean a decline in the company's financial condition.

This research is in line with research by [10] which found that Corporate Social Responsibility does not have a significant influence on company financial distress. With a significance value of 0.455 which is much greater than 0.05, this research shows that Corporate Social Responsibility does not directly influence Financial Distress. Indicates that other factors may be more dominant in determining the company's financial condition. This emphasizes the need for further research to understand the complexity of the factors that influence financial distress in companies.

The Influence of Corporate Governance Disclosure on Financial Distress

Corporate governance in a company plays a crucial role in determining the direction and goals of the company through the functions and tasks carried out by each organ within it. The corporate governance mechanism emphasizes the importance of transparency in company management which is relevant to the authority granted by the principal. This transparency aims to minimize information asymmetry between various related parties. Maximum implementation of corporate governance is believed to be able to improve the company's financial performance and minimize the risk of financial distress [7]. Through good corporate governance practices, companies can manage risks more effectively, strengthen investor confidence, and increase their competitiveness in the market.

Based on agency theory, it is explained that corporate governance in practice emphasizes the importance of transparency in company management which is relevant to the authority granted by

the principal. Apart from that, stakeholder theory describes how companies can fulfill all stakeholder rights as an effort to manage and maintain relationships with stakeholders. This research obtained results that are in line with the theory that has been described. Thus, the existence of a company is greatly influenced by the support provided by stakeholders to the company. If the company does not pay attention to stakeholders, it is not impossible that it will reap protests, and this will eliminate the company's legitimacy in the eyes of stakeholders [13].

The results of this study support the hypothesis that Corporate Governance Disclosure disclosure has a significant negative effect on financial distress. With a significance value of 0.008 which is much smaller than 0.05, it can be concluded that corporate governance disclosure has a significant negative effect on the company's financial condition. This finding is in line with previous research conducted by [7] and [11], which states that companies with good management have a lower probability of facing financial problems. This research shows that transparency in corporate governance directly influences financial distress.

CONCLUSION

Fundamental Finding: This study reveals that corporate governance disclosure significantly reduces financial distress in manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the 2019–2022 period. In contrast, environmental and social disclosures show no significant effect on financial distress. **Implication:** The findings highlight the critical role of corporate governance in mitigating financial difficulties, suggesting that companies should prioritize governance improvements to enhance financial stability. However, the lack of impact from environmental and social disclosures calls for a reassessment of how these factors are integrated into financial risk management. **Limitation:** The study is limited by its focus on a small sample of 12 manufacturing companies and a specific four-year period, which may limit the generalizability of the results. **Further Research:** Future studies should explore a larger and more diverse sample, including companies from various sectors, and examine the potential long-term effects of environmental and social disclosures on financial distress.

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* **Ainur Mutasyah**

Muhammadiyah University of Gresik

Email: tasyah055@gmail.com

Anwar Hariyono

Muhammadiyah University of Gresik

Email: anwar_hariyono@umg.ac.id
