

ESG disclosure and company profitability: Does company size play a role?

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ABSTRACT

Purpose — *This study aims to examine the relationship between Environmental, Social, and Governance (ESG) disclosures and profitability, with firm size as a moderating variable.*

Method — *This study employs a quantitative approach using Moderated Regression Analysis (MRA) techniques. The sample consists of 52 companies listed on the Indonesia Stock Exchange from 2017 to 2021.*

Result — *We found that ESG disclosure has a significant negative effect on profitability, using ROA as a proxy. Additionally, company size moderates the relationship between ESG disclosure and ROA profitability.*

Practical implications — *The study implies that disclosing corporate ESG activities incurs relatively high costs, which may reduce ROA in the short term. However, large companies are likely to have access to capital and resources that can help overcome ESG-related costs and ultimately increase ROA in the long term.*

Keywords: *ESG disclosure, profitability, company size*

INTRODUCTION

In recent years, public and regulatory demands have forced companies to disclose information about Environmental, Social, and Governance (ESG) practices. This has encouraged investors and companies to pay attention to ESG issues. Companies are increasingly required to not only concentrate on financial performance but also consider how their actions impact society and the environment. ESG disclosure is a way for companies to show their commitment to sustainable development. Research by Alfian et al. (2024) shows that ESG variables significantly affect the improvement of socio-economic development. For companies with the highest ESG performance, corporate sustainability may be favorable, while other companies may experience difficulties because it is costly to achieve (Cupertino et al., 2021). Through ESG disclosure, companies can communicate to stakeholders the best practices in managing environmental, social, and governance issues. This can provide benefits for companies, such as improving reputation, gaining investor trust, and encouraging consumer loyalty. Therefore, there is a need to conduct research on the relationship between ESG disclosure and corporate financial performance, such as profitability.

However, it is important to note that the relationship between ESG disclosure and corporate profitability is not fully understood and remains an interesting subject of research. There is ongoing debate regarding this relationship. Some studies show that ESG disclosure positively impacts profitability, while other studies find negative or insignificant results. For instance, findings indicate that ESG performance has a positive and significant influence on firm profitability (Shakil et al., 2019; Naeem & Çankaya, 2022), but it can negatively impact firm market value. Conversely, Grisales & Caracuel (2019), Yuen et al. (2022), and Makridou et al. (2023) found that ESG activities negatively affect profitability.

Considered an important component, company size has the ability to influence the relationship between CSR/ESG disclosure and profitability, which has a positive impact on firm value (D'Amato & Falivena, 2020; Abdi et al., 2022; and Adhi & Cahyonowati, 2023). Abundant



resources, open access to capital markets, and higher visibility in the eyes of stakeholders mean that large companies are perceived to be more active in ESG disclosure and thus derive significant benefits from such practices.

The novelty of this study lies in its approach, particularly in considering company size as a moderating variable in the relationship between ESG disclosure and profitability. Previous studies have shown mixed results regarding the effect of ESG disclosure on profitability, primarily focusing on the banking sector. However, this study complements the existing literature by exploring all sectors of companies in developing countries such as Indonesia and noting the important role of company size in strengthening this relationship. Company size reflects various market forces, operational complexity, and access to resources. In other words, it is necessary to understand whether the relationship between ESG disclosure and profitability can be moderated by firm size, or whether this relationship will differ across firms of different sizes.

The aim of this study is to investigate the moderating effect of firm size on the relationship between ESG disclosure and profitability. By considering these elements, this research provides valuable insights for companies in making informed decisions regarding their ESG disclosure practices. Additionally, it assists investors in evaluating ESG factors when making investment decisions.

METHOD

This research adopts a quantitative approach and utilizes purposive sampling, encompassing all companies listed on the Indonesia Stock Exchange from 2017 to 2021, resulting in a sample size of 52 companies. Data were sourced from company financial reports, sustainability reporting, and ESG Intelligence databases.

The dependent variable, profitability, is proxied by return on assets (ROA), while the independent variable is the disclosure of environmental, social, and governance (ESG) factors contained in sustainability reports. The moderating variable of company size is represented by total assets. Control variables encompass company age, leverage (ratio of total debt to total assets), revenue, and market capitalization.

Inclusion of company age as a control variable is crucial, reflecting the level of experience and stability of the company. Younger companies may employ different disclosure strategies compared to older ones. High leverage levels can limit resources allocated to ESG disclosure, potentially impacting profitability. Conversely, companies with higher revenues have optimal resources for ESG practices, affecting profitability. Moreover, companies with high market capitalization have greater resource access and may influence investor perception and trust, potentially enhancing profitability. Including these control variables allows the study to focus on the direct influence of ESG disclosure on profitability, enhancing understanding of the relationship while eliminating effects from unexamined variables.

Data analysis employs Moderated Regression Analysis (MRA) using the STATA application. The regression equation model is as follows:

$$ROA_{it} = \alpha + \beta_1 ESG_{it} + \beta_2 SIZE_{it} + \beta_3 ESG * SIZE_{it} + \beta_4 AGE_{it} + \beta_5 LEV_{it} + \beta_6 REV_{it} + \beta_7 MC_{it} + \varepsilon_{it}$$

Description: ROA = Return on Assets; ESG = ESG Disclosure; SIZE = Company Size; AGE = Company Age; LEV = Leverage; REV = Revenue; MC = Market Capitalization; α = Constant; β = Coefficient; ε = Error.

Hypotheses development

The effect of ESG disclosure on profitability

Companies adopting ESG disclosure practices tend to cultivate stronger relationships with stakeholders (Durlista & Wahyudi, 2023). Effective ESG disclosure can enhance a company's reputation (Safriani & Utomo, 2020) and foster trust among stakeholders (Amalia & Kusuma, 2023). Moreover, there is a growing societal interest in ESG issues, with support often directed towards companies with positive reputations. Consequently, organizations must maintain legitimacy by aligning their actions with societal expectations (Inawati & Rahmawati, 2023). Therefore, robust ESG disclosure practices can bolster corporate reputation, potentially leading to increased sales and overall return on assets (ROA).

To fully leverage the benefits of ESG disclosure practices, companies should comprehensively integrate ESG principles into their business strategies, aligning with stakeholder values and preferences. By doing so, companies can capitalize on opportunities arising from shifts in stakeholder behavior towards ESG issues, ultimately enhancing profitability in the long term. Based on this theoretical framework, the following hypothesis is proposed:

H1: ESG disclosure positively influences profitability

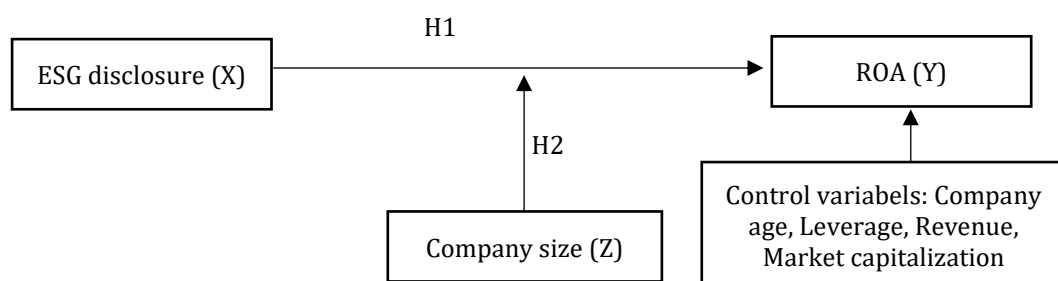
The effect of company size in moderating the relationship between ESG disclosure and profitability

In the pursuit of ESG practices, substantial funds are required to develop environmentally friendly systems, infrastructure, and social and community engagement programs. Larger companies typically possess greater resources to manage ESG practices and facilitate comprehensive disclosures. This enables them to allocate more funds and manpower towards studying, measuring, and reporting ESG impacts. Large companies also face heightened scrutiny from diverse stakeholders in support of green innovation, an often overlooked yet crucial characteristic that companies can leverage to create strategic value (Mansour et al., 2024).

ESG disclosure has the potential to yield long-term benefits, including enhanced operational efficiency, risk mitigation, and bolstered reputation, ultimately leading to improved return on assets (ROA) (Inawati & Rahmawati, 2023) and garnering legitimacy for social and environmental concerns, which positively impact corporate sustainability (Amalia & Kusuma, 2023). Consequently, larger companies have the potential to amplify the influence of ESG disclosure on profitability. Based on this theoretical framework, the following hypothesis is proposed:

H2: Company size moderates the impact of ESG disclosure on profitability

Figure 1. Research framework



Source: Developed by the authors (2024)

RESULT AND DISCUSSION

Descriptive statistics

Based on the descriptive statistics presented in Table 1, the average value of the profitability variable (ROA) is 0.045, with a standard deviation of 0.091. The minimum recorded value of -0.578 corresponds to PT Garuda Indonesia, Tbk in 2021, while the maximum value of 0.527 is attributed to PT Multi Bintang Indonesia, Tbk in 2017.

Table 1. Descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	260	0.045	0.091	-0.578	0.527
ESG	260	2.001	3.757	0.121	56
M_SIZE	260	31.343	1.632	27.793	35.084
AGE	260	18.973	10.71	0	44
LEV	260	1.2	2.167	-6.553	24.849
REV	260	3.443	0.422	0	3.764
MC	260	23.29	3.31	0	27.516

Source: Processed data (2024)

The ESG variable exhibits an average value of 2.001 with a standard deviation of 3.757. The minimum value of 0.121 is attributed to PT XL Axiata, Tbk, while PT Bumi Resources, Tbk recorded the maximum value of 56. Regarding the company size variable (SIZE), proxied by total assets, the average value is 31.343 with a standard deviation of 1.632. PT Pan Brothers, Tbk, in 2017, holds the minimum value of 27.793, while PT Bank Mandiri, in 2021, has the maximum value of 35.084. The company age control variable (AGE) has an average of 18.973 years with a standard deviation of 10.71 years. The minimum value of 0 years indicates that the company was registered at the beginning of the observation period, exemplified by PT BSI and PT Phapros. The maximum value of 44 years is observed at PT Solusi Bangun Indonesia Tbk.

The leverage control variable (LEV) displays an average of 1.2 with a standard deviation of 2.167. PT Garuda Indonesia, Tbk, in 2020, reports the minimum value of -6.553, whereas PT Bumi Resources, Tbk, in 2020, reports the maximum value of 24.849. For the income control variable (REV), the average value is 3.443 with a standard deviation of 0.422. The minimum value of 0 is recorded by PT Bank CIMB Niaga, Tbk, and PT BSI, Tbk, while the maximum value of 3.764 is recorded by PT Astra Internasional, Tbk, and PT BRI, Tbk, in 2021. Lastly, the market capitalization control variable (MC) demonstrates an average value of 23.29 with a standard deviation of 3.31. The minimum value is 0, and the maximum value of 27.516 is attributed to PT BCA, Tbk.

Pearson correlation

The results of the Pearson correlation test presented in Table 2 reveal that there is no statistically significant association between the ESG and ROA variables, as indicated by a correlation coefficient of -0.104. A correlation of -0.256* between SIZE and ROA suggests a weak association between these variables, which is statistically significant at the 0.1 significance level. Conversely, the correlation between AGE and ROA is 0.270*, indicating a weakly positive association. This association is also statistically significant at the 0.1 significance level. Regarding the control variables, the correlation coefficients between LEV and ROA, as well as REV and ROA, are 0.025 and 0.110, respectively. These correlations suggest no statistically significant associations between these variables and ROA. Meanwhile, the correlation coefficient between MC and ROA is 0.166*, indicating a somewhat favorable association between these variables. This association is also statistically significant at the 0.1 significance level.

Table 2. Pearson correlation

Variable	ROA	ESG	SIZE	AGE	LEV	REV	MC
ROA	1.000						
ESG	-0.104	1.000					
M_SIZE	-0.256*	0.041	1.000				
AGE	0.270*	0.054	0.109	1.000			
LEV	0.025	0.709*	-0.135	-0.016	1.000		
REV	0.110	-0.056	0.261*	0.240*	-0.110	1.000	
MC	0.166*	-0.004	0.278*	0.139	-0.019	0.333*	1.000

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Source: Processed data (2024)

Moderated Regression Analysis (MRA) test

Based on the MRA test results displayed in Table 3, the adjusted R-squared value is 0.71, indicating that 71% of the variation in ROA can be explained by ESG and control variables. The analysis utilizes 260 observations. In the first column, the coefficient value of -0.005** and the t-value of -2.220 are consistently significant at the 0.05 and 0.1 levels, respectively. This implies that ESG disclosure significantly affects profitability. Moving to the second column, regression coefficients of the control variables are presented. Specifically, AGE has a coefficient of -0.006***, while LEV, REV, and MC have coefficients of 0.010, 0.006, and 0.001**, respectively. The moderation variable SIZE has a coefficient of -0.012, indicating that AGE and MC partially have a significant effect on profitability, whereas LEV, REV, and SIZE do not exhibit a significant effect. In the third column, the regression coefficient for the interaction of ESG disclosure and SIZE is 0.007*, indicating that the SIZE variable moderates the relationship between ESG disclosure and profitability. This suggests that the association between ESG disclosure and profitability is influenced by the SIZE variable.

Table 3. MRA test results

	ROA	ROA	ROA
Intercept	0.156***	0.509	0.795*
	(3.224)	(1.418)	(1.868)
ESG	-0.005**	-0.005**	-0.211*
	(-2.220)	(-2.206)	(-1.877)
AGE	-0.006***	-0.006**	-0.006**
	(-2.630)	(-2.134)	(-2.150)
LEV	0.010	0.010	0.011
	(1.352)	(1.300)	(1.445)
REV	0.005	0.006	0.004
	(1.165)	(1.455)	(1.026)
MC	0.001**	0.001**	0.001*
	(1.978)	(2.025)	(1.695)
M_SIZE		-0.012	-0.021
		(-0.986)	(-1.470)
c.ESG#c.M_SIZE			0.007*
			(1.848)
Adj.R2	0.71	0.71	0.71
N	260	260	260
F-stat	52.519	47.034	43.993

Source: Processed data (2024)

Discussion

The effect of ESG disclosures on profitability

Based on the test results in Table 3, it is evident that ESG disclosure has a significant negative effect on profitability (ROA), with a coefficient value of -0.005** at the p-value level <0.05 and <0.10 . ESG (Environmental, Social, and Governance) disclosure refers to a company's practice of divulging information about its environmental, social, and corporate governance impacts. Despite being considered a responsible practice with the potential to enhance corporate reputation, the findings of this study indicate a negative effect.

This negative effect stems from the high costs associated with ESG activities that companies are required to disclose. Stakeholders play a vital role in urging management to steer the company towards professional and sustainable practices aligned with the principles of good corporate governance (GCG). However, this entails allocating resources to report information on ESG activities and investing more funds in environmentally friendly infrastructure or social programs. Such investments require substantial initial capital, which may lead to a decrease in return on assets (ROA) in the short term. Companies may also incur losses during adverse economic conditions due to the time and resource-intensive nature of ESG activities (Taliento et al., 2019).

Through stakeholder involvement in ESG activity disclosure, companies can maintain positive relationships with stakeholders. This aligns with legitimacy theory, which emphasizes the importance of ensuring that a company's operations adhere to legal standards and societal values and norms (Ghozali, 2020). Once investments reach a certain level and practical achievements are implemented, ESG practices can yield optimal results (Putri & Puspawati, 2023). However, if the costs associated with ESG activities are not offset by substantial benefits, it can have a negative impact on overall profitability.

Research by Albitar et al. (2020) and Kalia & Aggarwal (2023) suggests that participation in ESG activities positively impacts company performance, particularly in developed countries, whereas the relationship may be negative or insignificant for developing countries. Other studies by Buallay (2019), Alareeni & Hamdan (2020), Dakhli (2022), Singh et al. (2023), and Kwintana & Hanggraeni (2023) indicate that separate measurements of ESG components, such as corporate social responsibility, environment, and corporate governance, have a negative effect on ROA and ROE. This implies that higher levels of ESG disclosure are associated with lower financial performance (Putriningtyas et al., 2024).

Yuen et al. (2022) found that ESG activities can reduce bank profitability, supporting the trade-off theory, which suggests that implementing ESG standards can increase costs while decreasing profitability. However, ESG activities can also help improve firm performance in the long run. Conversely, research by Velte (2017) suggests that ESG performance can enhance ROA, with governance performance having the most significant impact on financial performance compared to environmental and social performance. Buallay's (2022) research findings indicate no significant relationship between ESG and ROA and market performance (TQ).

Company size in moderating the effect of ESG disclosure on profitability

The MRA test results demonstrate that company size moderates the effect of ESG disclosure on ROA profitability, with a coefficient value of 0.007* and a p-value <0.10 . Larger companies typically have better access to capital and resources, which aids in overcoming ESG-related costs. Company size has been identified as a significant background factor (Taliento et al., 2019). Additionally, due to lower uncertainty risk, larger companies are more likely to attract investors (Putri & Puspawati, 2023).

Companies with a larger scale are better equipped to generate additional resources to enhance operational efficiency and introduce environmentally friendly technology with the assistance of stakeholders, ultimately leading to increased ROA. This aligns with Rahmawati et al. (2023), who

found that company size moderates the relationship between CSR disclosure and company profitability. The rise in ROA is a consequence of implementing sustainable ESG practices. This finding carries implications for stakeholder theory, where stakeholder pressure encourages corporate ESG disclosure implementation. Larger companies typically engage with a broader range of stakeholders (Handayati et al., 2022).

Mansour et al. (2024) discovered that the impact of green innovation on firm performance significantly increases with the involvement of company size. Large firms can capitalize on green innovations to boost productivity, avoid penalties, tap into new markets, enhance environmental reputation, gain a competitive edge, and ultimately improve overall firm performance. Osuji (2023) revealed that bank size significantly moderates the relationship between governance risk management and ROE.

Moreover, profitability and company size can moderate the effect of corporate social responsibility disclosure on firm value (Handayati et al., 2022). Larger companies often disclose their performance more extensively, including not only financial statements but also social information, to enhance the company's image and increase its value. Additionally, Alfalih's (2023) findings suggest that economic conditions positively moderate the impact of various ESG disclosure practices on financial performance.

CONCLUSION

The aim of this study is to explore the relationship between ESG disclosure and profitability, with company size serving as a moderating variable. The findings reveal that ESG disclosure significantly negatively impacts ROA profitability. In addition, the study indicates that firm size moderates the relationship between ESG disclosure and ROA profitability.

This study underscores the importance of ESG activity disclosure by companies, despite the high associated costs. Stakeholder support plays a crucial role in encouraging management to adopt professional and sustainable practices. Additionally, regulatory intervention is vital in promoting the implementation of corporate ESG practices. Establishing a set of rules and guidelines can accelerate the adoption of ESG practices and mandate companies to disclose such activities in their published reports.

However, this study has limitations. Researchers aggregated companies from various sectors, including both financial and non-financial industries. For future research, it is recommended to segregate companies based on their respective industries to yield more accurate and unbiased results. Furthermore, the availability of consistent corporate ESG data remains limited. Future studies could benefit from utilizing complete and comprehensive ESG time series data and incorporating moderating variables such as ESG controversy, geographic location, greenwashing, or environmentally vulnerable industry sectors.

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