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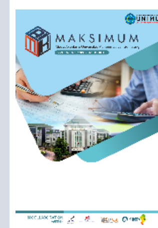

Evaluating Financial Performance Based on Environmental Performance, Environmental Costs, and Environmental Disclosure

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Abstract

This study examines the relationship between environmental performance, environmental costs, and environmental disclosures with financial performance among companies in the basic materials and consumer non-cyclical sectors listed on the Indonesia Stock Exchange from 2021-2023. Utilizing a quantitative approach with panel data regression analysis, the study reveals that environmental disclosure positively impacts financial performance, while environmental performance and costs show no significant effect. The findings indicate that transparent sustainability reporting enhances stakeholder confidence and company reputation, improving financial outcomes. The results align with legitimacy theory, emphasizing the importance of aligning corporate activities with societal norms to achieve long-term financial stability. Despite the increasing global emphasis on sustainability, the study underscores the need for greater public awareness and investment in environmental initiatives to realize their full financial benefits. This research implies that companies must gain social approval to survive long term. By aligning its activities with societal values, companies can build social legitimacy and reduce reputational risks.

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Introduction

The company's operations must be connected to the environment and natural resources (Lestari & Kusuma, 2022). In utilizing the available natural resources and environment, the company must be able to use them reasonably. However, with the natural resources and environment available, some companies still abuse this potential to increase profits, such as polluting the environment, exploiting, and not caring about the impact of their activities on the environment and society (Meiyana & Aisyah, 2019). Profit is one of the factors that can be measured to assess a company's financial performance (Budi & Zuhrohtun, 2023). Good financial performance is characterized by positive company growth, and poor financial performance is characterized by negative company growth (Fujianti, 2022).

Companies in the raw materials sector, such as PT Aneka Tambang Tbk, PT Polychem Indonesia Tbk, PT Indah Kiat Pulp & Paper Corp Tbk, and PT Suparma Tbk, experienced a decline in financial performance. Thus, the company's ROE value in 2018-2022 does not meet established industry standards. The industry average standard for Return On Equity (ROE) value is 40% or 0,4 (Shofwatun et al., 2021). This means that the percentage of profit obtained from capital is still small. Apart from that, in 2023, Timah Tbk experienced a loss for the year of IDR 449.7 billion, which was partly caused by a decrease in sales volume and poor governance of tin, including licensing and supervision problems, which hampered the growth of PT Timah Tbk, which had an impact on decreasing performance finance (Rahmawati, 2024).

Good environmental performance benefits companies in achieving a balance between business activities and the expectations of society and stakeholders (Yuniarti et al., 2023). The government has a vital role in preserving the environment through the regulation UU No. 32 of 2009 and the PROPER program to monitor and control company pollution activities (Arifbillah & Suhartini, 2020). The non-cyclical consumer sector contributes significantly to environmental damage, primarily through plastic waste (Nuraini & Murtanto, 2022). Environmental pollution cases are still prevalent in Indonesia, causing severe consequences for the environment Priliana and Ermaya (2023), such as the case of environmental pollution by PT Tjiwi Kimia Tbk, which was sanctioned due to its production waste polluting the Brantas Porong River (Tribunnews.com, 2021). PT Unilever Indonesia Tbk and PT Mayora Indah Tbk contributed to Indonesia's plastic waste pollution (Tempo.co, 2022). In addition, companies still get a red PROPER rating, such as PT Unggul Indah Cahaya Tbk, which is engaged in petrochemicals (Harianbanten, 2022).

The phenomenon shows that companies still violate and ignore the environmental damage or restoration caused by company operations. The occurrence of these cases has the potential to damage the environment, impact the community, and worsen the company's reputation in the eyes of the community and stakeholders. Hapsari et al. (2021) state that the company's financial performance will improve if its environmental performance improves; companies need to disclose environmental sustainability data to stakeholders to avoid ultimatums from the community.

When carrying out environmental performance and its responsibilities in the environmental field, a company certainly requires costs; the costs arising from environmental performance are called environmental costs (Suandi & Ruchjana, 2021). The allocation of funds for environmental costs is a form of the company's contribution and commitment to environmental sustainability (Evita & Syafruddin, 2019). Ermaya & Mashuri (2020) state that expenses related to the environment can influence a company's profitability because disclosing environmental costs highlights the financial impact and demonstrates the company's environmental commitment so that it can improve its reputation and affect positive financial performance. In addition, a factor that can affect financial stability is environmental disclosure. By

increasing shareholder confidence through environmental disclosure, the company can improve its social image, sales growth, and revenue, impacting financial performance (Wu & Li, 2023).

Several previous studies have examined the influence of environmental performance, environmental costs, and environmental disclosure on company financial performance, but more research results are still needed. Research by Setiadi (2021), Haninun et al. (2018), and Suaidah and Putri (2020) found that environmental performance has a positive effect on financial performance. Companies that perform well in the environment will receive a positive response from the community and stakeholders, increasing long-term revenues. However, research by Bellamy et al. (2022), Gilbertha and Pello (2024), Putri et al. (2020), and Suryaningrum and Ratnawati (2024) stated the opposite, that the application of PROPER in company environmental management does not necessarily improve financial performance because environmental performance takes a long time to be realized and depends on how much awareness stakeholders have of environmental issues.

The research results of Al-Waeli et al. (2022), Rahman and Wira (2023), Nababan and Hasyir (2019), and Putri (2023) stated that environmental costs have a positive effect on financial performance. A company's dedication to environmental policies can improve financial performance indirectly by building a solid public image and attracting investors who value sustainability. However, research by Cahyani and Puspitasari (2023), Nengzih (2022), Setiadi (2021), and Siregar et al. (2019) show that environmental costs do not affect financial performance because there are still many companies that have not paid for environmental prevention and management. Meanwhile, research by Erinoso and Oyedokun (2022), Haninun et al. (2018), Rosdiana and Mayangsari (2020), Wang et al. (2020), and Wu and Li (2023) stated that if companies carry out environmental disclosures, they can help companies achieve sustainability targets.

The novelty of this research compared to previous research is: (1) This research examines the basic materials and non-cyclical consumer sectors, which still need to be researched, compared to the mining and oil and gas sectors, which have been researched a lot before. Due to differences in industry characteristics, the influence of environmental disclosure and costs on financial performance may differ. (2) This research uses the ROE proxy to measure financial performance. (3) This research combines environmental performance, environmental costs, and environmental disclosure variables simultaneously for their influence on financial performance, whereas many previous studies have not considered environmental costs for research. Thus, this research has a significant effect in providing a more comprehensive understanding of the influence of environmental performance, environmental costs, and environmental disclosure on financial performance in the basic materials and consumer non-cyclical sectors, which have different characteristics from the mining and oil and gas sectors which have been widely studied. Previously.

This study analyzes the connection between a firm's environmental practices, environmental expenditures, and environmental transparency and its financial outcomes. Based on previous research gaps that show inconsistencies in research results. The difference in this study is the measurement of financial performance using the ROE proxy. This study is motivated by the rampant environmental pollution committed by several companies. The assessment of company performance not only relies on financial aspects alone but also considers the contribution to environmental sustainability. This aligns with the increasing global awareness of the importance of sustainability and environmental responsibility. This research can provide knowledge related to financial performance information and be used to evaluate the effectiveness of environmental programs that have been implemented. Companies can increase efforts to publicize environmental performance through various media to make the public and stakeholders more

aware of and appreciate these efforts. The difference between this study and previous studies is that most previous studies focus on the mining and oil-gas sectors.

In contrast, this study explores other less researched sectors, such as basic materials and consumer non-cyclical. Due to differences in industry characteristics, the impact of environmental disclosure and costs on financial performance can differ. In addition, many previous studies have yet to consider environmental costs to be researched.

Literature Review

Hypothesis Development

Impact of Environmental Performance on Financial Performance

The operational sustainability of a company depends on internal smoothness and profits earned. However, it is also determined by the interaction and impact of its business activities with society and the environment (Durlista & Wahyudi, 2023). The link between legitimacy theory and environmental performance is that good environmental performance is a must for companies as a form of responsibility for environmental sustainability; this will gain public acceptance to strengthen the company's legitimacy to operate (Darma et al., 2019). Financial performance assessment based on PROPER standards can increase investment because it shows the company's commitment to environmental management. Thus, the public will have a good impression of the company (Haninun et al., 2018). Long-term investors prioritize sustainable companies because green practices support business sustainability (Hadiwibowo et al., 2023). Analysis performed by Setiadi (2021), Haninun et al. (2018), and Suaidah and Putri (2020) states that companies that perform environmentally performance well will get a positive response from the community and stakeholders it has an impact on increasing income in the long term, this indicates that companies with a solid commitment to environmental sustainability will experience increased profits.
H1: *Environmental performance influences financial performance*

The Impact of Environmental Coston Financial Performance

The negative impact of the company's production process on the environment triggers the emergence of environmental costs. Environmental costs are expenses that the company must bear to overcome environmental damage (Cahyani & Puspitasari, 2023). Many companies still view environmental costs as an additional burden that can reduce company profits (Syabna & Nasihin, 2023). The allocation of funds for environmental management is a burden and a long-term investment to improve reputation through commitment and social responsibility (Lao & Hamiddin, 2021). The connection between legitimacy theory and environmental costs is that legitimacy theory emphasizes the importance of companies allocating environmental costs to avoid the risk of more significant losses in the future; this risk can be in the form of loss of recognition from society and a bad company image (Kaat & Sofian, 2023). Research conducted by Al-Waeli et al. (2022), Rahman and Wira (2023), Nababan and Hasyir (2019), and (Putri, 2023) states that a company's dedication to environmental policies can enhance its financial performance indirectly by building a solid public image and attracting investors who appreciate sustainability, instead of establishing a direct correlation between environmental costs and commercial gains.
H2: *Environmental costs impact financial performance*

The Impact of Environmental Disclosure on Financial Outcomes

Environmental disclosure is a must for all companies in Indonesia. This is important because environmental disclosure is a consideration for the public and investors when making decisions (Suyanto et al., 2022). Environmental information disclosure is a form of responsibility to investors and broad corporate accountability to all stakeholders (Deswanto & Siregar, 2018). Environmental disclosure relates to

legitimacy theory, namely that companies must follow community values and standards to maintain legitimacy (Tahu, 2019). Taufiq and Pratiwi (2022), businesses that engage in proactive environmental reporting tend to see positive financial results; environmental disclosure is essential because companies must be responsible to society and other stakeholders. The results of this study are in line with research conducted by Erinoso and Oyedokun (2022), Ariyani and Putri (2024), Rosdiana and Mayangsari (2020), and Durlista and Wahyudi (2023) stating that if the company makes environmental disclosures, it can help the company in achieving its sustainability targets.
H3: *Environmental disclosure influences financial performance*

The Impact of Environmental Performance, Environmental Costs, and Environmental Disclosure on Financial Performance
Environmental performance is the company's commitment to environmental sustainability realized through various initiatives to balance business operations and community expectations (Yuniarti et al., 2023). The implementation of environmental performance is undoubtedly related to environmental costs. The number of environmental costs incurred by the company for environmentally oriented activities will be perceived as the company's concern and participation in maintaining environmental sustainability (Ermaya & Madhuri, 2020). The relationship between legitimacy theory and environmental performance, environmental costs, and environmental disclosure is that companies must ensure that their performance is acceptable to society; in this case, the manifestation of legitimacy can be in the form of environmental disclosure, which provides an overview of the company's responsibility towards the environment so that the company's operational activities are accepted by society and have an impact on stabilization. Finances in the long term (Saputra, 2020). Aulia et al. (2019) stated that by contributing to environmental sustainability and not pursuing profits alone, the company will build public and stakeholder trust to encourage the sustainability of company operations, including improving financial performance. Research by Usemahu (2023) shows that environmental performance and environmental costs affect financial performance.
H4: *Environmental performance, environmental costs, and environmental disclosure influence financial performance*

Research Methods

The method in this research is a quantitative method with a descriptive approach. The data analysis technique used is the panel data regression analysis technique. The data that has been collected is then processed using Eviews software. The population in this study are companies in the basic materials and consumer non-cyclical sectors listed on the Indonesia Stock Exchange in 2021-2023. The total population is 231 companies. Consists of 106 basic materials sector companies and 125 consumer non-cyclical sector companies. The sampling method used is purposive sampling. The results obtained from the purposive sampling method obtained 16 companies in the basic materials and consumer non-cyclical materials sectors that met the sample criteria.

Table 1. Variable Measurement

Variable	Variable Measurement	Source
Financial Performance	$ROE = \frac{Profit}{Equity}$	Winarno (2019)
Environmental Performance	The scoring system uses a color scale to measure financial performance. Each color represents a specific score: black (1), red (2), blue (3), green (4), and gold (5)	Hidayat and Aris (2023)

Environmental Cost	$\text{Environmental Cost} = \frac{\text{Cost}}{\text{Profit}}$	Nengzih (2022)
Environmental Disclosure	Environmental disclosure is measured using cheklist items that refer to the Global Reporting Initiative (GRI) G4. $\text{ED} = \frac{\text{Number of item disclosures}}{\text{Maximum number of disclosure}}$	Deswanto and Siregar (2018)

The data analysis technique in this research uses the Eviews8 application program. It uses panel data regression analysis with a regression equation.

$$FP = \alpha + \beta 1EP + \beta 2EC + \beta 3ED + e$$

Where:

FP = Financial Performance
α = Constants
β1, β2, β3 = Regression Coefficient
EP = Environmental Performance
EC = Environmental Cost
ED = Environmental Disclosure
e = Residual error

Result and Discussion

Table 2. Descriptive Statistical Test Results

	EP	EC	ED	FP
Mean	3.208333	0.042077	0.425244	0.125817
Maximum	4.000000	0.245500	0.705900	0.286800
Minimum	2.000000	0.000300	0.147100	0.015600
Observations	48	48	48	48

Source: data processed, 2024

The average financial performance in this study is 0.125817; this indicates that basic materials and consumer non-cyclical sector companies have a relatively small financial performance. The average environmental performance obtained is 3.208333, indicating the company's good performance on the environment because it has a blue PROPER rating category. The average environmental cost of 0.042077 indicates that companies allocate relatively tiny data sources to manage environmental impacts. Environmental disclosure shows an average of 0.425244, indicating that companies tend to be quite open in reporting information related to environmental practices and policies.

Based on financial performance data, the company with the best financial performance is PT Sawit Sumbermas Tbk in 2022. The lowest financial performance was PT Semen Baturaja Tbk in 2021. Environmental performance data for the 2021-2023 period, the companies with the best environmental performance are PT Aneka Tambang Tbk, PT Avia Avian Tbk, PT Indocement Tunggal Prakarasa Tbk, PT Vale Indonesia Tbk, and PT Semen Baturaja Tbk, all of which received a maximum score of 4. On the other hand, PT Sekar Laut Tbk's environmental performance is classified as the lowest, with a minimum score of 2 in 2021 and 2023. The company with the best environmental costs is PT Vale Indonesia Tbk in 2023, while

PT's environmental costs, Sampoerna Agro Tbk in 2021, are classified as the lowest with a value of 0.000300. The company with the best environmental disclosure by PT Sawit Sumbermas Tbk and PT Vale Indonesia Tbk in 2022-2023 with a value of 0.705900. On the other hand, PT Sekar Laut Tbk's environmental disclosure is classified as the lowest, with a minimum value of 0.1471.

Regression Model Selection Test

Tabel 3. Chow Test

Effects Test	Statistic	d.f.	Prob.
Cross-section F	5.925.298	-15,29	0.0000
Cross-section Chi-square	67.313.606	15	0.0000

Source: processed data (2024)

The Chow test is used to determine the appropriate model between the standard effect model (CEM) and the fixed effect model (FEM). If the probability value F is < 0.05, then the appropriate model is FEM, and if the probability value is > 0.05, then the model chosen is CEM (Basuki, 2021). Based on Table 3, the probability value of the F cross-section of 0.0000 is less than 0.05. Therefore, the FEM model was chosen, and the Hausman test needed to be carried out.

Table 4. Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	5.554.790	3	0.1354

Source: processed data (2024)

According to Table 4, the probability value is 0.1354, which is more significant than 0.05, indicating that the REM model is selected. Since the Chow and Hausman test results are inconsistent, a Lagrange multiplier test is necessary.

Table 5. Lagrange Multiplier Test

	Cross-section	Test Hypothesis Time	Both
Breusch-Pagan	12.6888	0.18121	12.87001
	(0.0004)	(0.6703)	(0.0003)

Source: data processed, 2024

According to the results of the Lagrange multiplier test. The Breusch-Pagan value is 0.0003, which is less than 0.05—indicating that the appropriate model to use is the Random Effect Model (REM).

Table 6. Multicollinearity Test Results

	EP	EC	ED
Environmental Performance	1.000	0.516	0.537
Environmental Cost	0.516	1.000	0.291
Environmental Disclosure	0.537	0.291	1.000

Source: data processed, 2024

The multicollinearity test was carried out to see whether or not there was a high correlation between the independent and dependent variables. If the correlation coefficient value is > 0.85, then there is multicollinearity. Table 6 is the finding of the multicollinearity test indicating the value of the correlation coefficient < 0.85. It can be concluded that multicollinearity does not occur.

Table 7. R Square and F Test

R-squared	0.165633	Mean dependent var	0.050173
Adjusted R-squared	0.108744	S.D. dependent var	0.034815
S.E. of regression	0.032868	Sum squared resid	0.047533
F-statistic	2.911.531	Durbin-Watson stat	1.983.996
Prob(F-statistic)	0.044870		

Source: data processed, 2024

Considering Table 7, the results of the coefficient of determination test obtained the Adjusted R Square coefficient value of 0.108744, which explains that the ability of environmental performance variables, environmental costs, and environmental disclosures to explain the financial performance variable is 10.87% and for the remaining 89.13% explained by other variables outside this study.

Table 7 displays the F test results from the simultaneous test, indicating a probability value of 0.044870, which is less than 0.05. This finding unequivocally confirms the influence of environmental performance, environmental costs, and environmental disclosure on financial performance. As a result, the fourth hypothesis of this study is accepted, reinforcing the main findings of the research.

Table 8. t Test Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.169655	0.055798	3.040.521	0.0040
Environmental Performance	-0.026872	0.018747	-1.433.415	0.1588
Environmental Cost	-0.275804	0.154168	-1.788.988	0.0805
Environmental Disclosure	0.126940	0.055260	2.297.162	0.0264

Source: data processed, 2024

Environmental Performance on Financial Performance

Environmental performance is the result of the company's efforts to protect the environment by carrying out its operations through the implementation of environmentally friendly practices (Cahyani & Puspitasari, 2023). The results of this study state that environmental performance does not affect the company's financial performance due to the lack of publication of PROPER ratings. Environmental conservation efforts by companies, such as reducing carbon emissions and effective waste management, do not always directly impact improving financial performance. The research results are not in line with legitimacy theory. Legitimacy theory emphasizes the importance of companies in ensuring the suitability of their operational activities with community norms; if the company fails to fulfil its social contract, it can result in a loss of stakeholder trust (Maesaroh et al., 2022).

The PROPER rating, used as a medium to publicize environmental performance, does not positively increase Return on Equity. If environmental performance does not improve financial performance, it shows that not all investors value environmental performance as an investment indicator because good environmental performance cannot always benefit investors (Kore & Prasasyaningsih, 2023). According to

the findings of the research by Bellamy et al. (2022), Gilbertha and Pello (2024), Putri et al. (2020), Suryaningrum and Ratnawati (2024) stating that the implementation of PROPER in corporate environmental management does not automatically improve the company's financial performance due to environmental performance takes a long time to materialize and depends on how much stakeholder awareness of environmental issues.

Environmental Costs on Financial Performance

The allocation of funds for environmental costs is a form of the company's contribution and commitment to environmental sustainability (Evita & Syafruddin, 2019). The results of this study state that environmental costs do not affect financial performance, so the second hypothesis is rejected. Environmental costs do not affect the company's financial performance because investments in environmental initiatives usually require high initial costs, such as developing green technology or meeting regulatory standards, which can reduce profits in the short term. The study's findings contradict the legitimacy theory. Legitimacy theory emphasizes the importance of companies allocating environmental costs to avoid the risk of more significant losses in the future; this risk can be in the form of loss of recognition from society and a bad corporate image (Kaat & Sofian, 2023). The effectiveness of corporate legitimacy efforts through environmental costs in improving financial performance depends on the transparency and clarity of corporate reporting. The findings of this investigation are consistent with research conducted by Cahyani and Puspitasari (2023), Nengzih (2022), Setiadi (2021), Siregar et al. (2019), showing that environmental costs do not affect financial performance. Many companies still need to make expenditures for environmental prevention and management because the expenses related to the company's environmental activities are considered an extra burden.

Environmental Disclosure on Financial Performance

Environmental disclosure transmits information about the company's environmental impact to the public through a company report containing data related to its operational activities (Ningtyas & Triyanto, 2019). The results of this study show that environmental disclosure affects financial performance, so the third hypothesis is accepted. Environmental disclosure affects financial performance because transparency about corporate environmental practices can improve the reputation and confidence of stakeholders. When companies publicly report their impact and efforts in preserving the environment, it can improve the company's image in the eyes of investors. Legitimacy theory places constraints on corporate values and environmental disclosure standards. If the company's values differ from society's, this can endanger the company's legitimacy (Tahu, 2019). The system's perspective formed by the theory sees the company as an entity that interacts with the community through a commitment to environmental conservation to ensure its operational sustainability (Supadi & Sudana, 2018). Research results are in line with research conducted by Erinoso and Oyedokun (2022), Haninun et al. (2018), Rosdiana and Mayangsari (2020), Wang et al. (2020), Wu and Li (2023) state that if companies make environmental disclosure, then it can help companies in achieving their sustainability goals.

Environmental Performance, Environmental Cost, and Environmental Disclosure on Financial Performance

Environmental performance, costs, and disclosure simultaneously affect financial performance because these elements are interrelated in creating long-term value for a company. Good environmental performance reflects operational efficiency and efficient resource management, which can reduce operating costs and environmental risks. Environmental, although they can reduce short-term profits, are an essential investment in achieving good environmental performance. Environmental disclosure, on the other hand, plays a vital role in increasing transparency and building trust among stakeholders. These

three factors, in turn, can increase revenue, lower costs, and reduce risk, all of which contribute positively to the company's overall financial performance.

The theory of legitimacy affirms that the company must ensure that its performance is acceptable to the public; in this case, the manifestation of legitimation can be a disclosure of the environment that gives an overview of the company's responsibility to the environment so that the public accepts its operational activities and have an impact on financial stability in the long term (Saputra, 2020). Research results align with research conducted by Cahyani and Puspitasari (2023), Haninun et al. (2018), and Rosdiana and Mayangsari (2020), indicating environmental performance influences financial performance. Implementation of environmentally friendly practices has the potential to improve financial performance significantly. Research by Al-Mawali (2021), Al-Waeli et al. (2022), Hapsari et al. (2021) suggests that environmental costs influence financial performance. Effective environmental cost management through proper allocation can lead companies to improved financial performance and a good reputation in the eyes of stakeholders. Research carried out by Erinoso and Oyedokun (2022), Haninun et al. (2018) and Wu and Li (2023) state that increasing companies' participation in releasing sustainability reports can bring positive responses and improve financial performance. So, transparent and comprehensive disclosure is the key to building confidence and supporting the company's long-term growth.

Conclusion

This research shows that environmental performance and costs do not impact financial performance. This is due to a lack of publication and public awareness and an early investment in environmental programs that reduce short-term profits. On the contrary, environmental disclosure has been shown to impact financial performance. Transparent sustainability reporting on environmental efforts enhances stakeholder reputation and confidence. Simultaneously, environmental performance, costs, and disclosure influence financial performance by creating long-term value and synergies that strengthen stakeholder relationships. This study's results align with the theory of legitimacy that emphasizes the importance of corporate performance alignment with social norms to acquire legitimacy and improve long-term financial stability.

The limitation of this study is the small sample size, so the research cannot be generalized to all essential materials and consumer non-cyclical companies. In addition, the company's inconsistent PROPER data limits the research analysis. Further research can add other variables, such as green innovation and firm size, as it can provide a more comprehensive analysis of how these three initial variables influence financial performance.

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