

ANALYSIS OF THE IMPACT OF FINANCIAL PERFORMANCE (ENVIRONMENTAL, SOCIAL, GOVERNANCE) ON COMPANY INVESTMENT RISK

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Abstract

The impact of financial performance on a company's investment risk can be very significant. Poor financial performance can cause various risks for a company, including a decline in share value, risk of bankruptcy, and even forced delisting from the stock exchange. Poor financial performance can adversely affect the value of the company. Good financial performance can help increase a company's value and profitability. Effective financial risk management can help Businesses recognize, quantify, and handle risks associated with their financial performance, thereby minimizing their negative impact. ESG is an important factor in business and investment because it helps companies manage risk, build reputation and create favorable effects on society and the environment. A deeper understanding of this concept is key to ensuring that companies and investors can contribute to a more sustainable world. This research in-depth investigates the analysis of the use of the literature research approach to examine how financial performance (environmental, social, and governance) affects the investment risk of a corporation. The definition of financial, environmental, social, and governance performance is covered in this study, along with how financial performance affects firm investment risk and how environmental, social, and governance factors influence financial performance.

Keywords: Financial performance, ESG, company investment risk

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INTRODUCTION

Investment can be defined as a promise to invest a specific sum of money now in order to generate profits later on. More broadly, the benefit of forward earnings activity in recent years has been in response to economic and social conditions. Companies as a collective economic community must be responsible for overcoming economic, environmental and societal issues (Xie et al., 2019). The Environmental, Social and Governance (ESG) platform microsite was launched by the Indonesian Stock Exchange, PT Kliring Penjaminan Efek Indonesia, and PT Kustodian Sentral Efek Indonesia, with the assistance of OJK. As stated, the purpose of this launch is to assist in achieving the Sustainable Development Goals in the Phase II Sustainable Finance Map from 2021 to 2025, sustainable capital market growth is in accordance with financial practices. As support on the road to Indonesia's G20 Presidency in 2022 (Shakil et al., 2019).

In general, environmental, social, and corporate governance (ESG) refers to a wide range of factors that may affect a company's capacity to carry out its business plan and create long-term value. As public awareness of social and environmental issues increases. Businesses are still urged to consider the effects that their operations have on the community and the environment in addition to the pursuit of profit. The Financial Services Authority mandates that issuers submit sustainable reports to the public detailing their economic, financial, social, and environmental performance. The government, in its capacity as regulator, also oversees the application of sustainable finance for public companies. Since 2019, issuers have been subject to sustainability reports specific to their industry, and these reports will be implemented comprehensively in 2025 (Atan et al., 2018). Environmental, social, and governance (ESG) principles are used to disclose a company's performance. The company's adoption of good corporate governance standards is intended to adhere to the GCG principles of people, planet, and profit. Good and accurate GCG implementation will benefit the business itself and help it build a positive reputation with the public and investors. In addition, enhancing a business's reputation can boost customer confidence and can eventually affect how well the business performs. Company performance is a metric used by companies to determine the success of their profitability. Company performance is its ability to explain its business activities (Wang, Z., & Sarkis, 2017).

Triple Bottom Line is a concept related to three important assumptions, namely economic prosperity, environmental quality and social justice. These three assumptions are defined as the basics that influence the existence of a

sustainable business. Triple Bottom Line is clearly a concept for measuring company performance from an economic, social and environmental perspective. This concept continues to develop until now, better known as Environmental Social Governance (ESG).

Environmental, Social, and Governance are the three principles or criteria that make up Environmental Social Governance (ESG), a corporate investing practice guideline. Applying ESG principles to business and investment activities also entails integrating and putting into practice corporate policies that support the three concepts' sustainable development. In response to calls for sustainable economic growth, the business sector launched ESG. While sustainable finance is being embraced by the banking industry, investors at the regional, national, and international levels are using ESG principles, guidelines, and criteria more and more. Investors have basic questions about companies that use the idea and implementation of ESG standards when investing or not investing in companies or businesses (Lee, M. T., & Suh, 2022).

Company performance describes the ability it has in managing and allocating its resources so that it is something that must be achieved by every business actor. From this it can be concluded that company performance is what the company has achieved in a certain period which is related to predetermined criteria. Company performance must reflect measurable results and take into account the company's empirical conditions on various agreed measures. Performance evaluation is carried out to determine the services provided.

Performance evaluation is the process of regularly assessing an organization's operational performance, organizational parts, and people against given goals, criteria, and performance. As a research measurement to evaluate company performance, it can be considered to use the rate of return represented by ROE and company value, namely Tobin's Q. The ratio of net profit to equity is called return on equity, or ROE. The rate of return, or ROE on equity is also often referred to as the rate of return on net worth, namely the capacity of an organization to earn a profit from its own capital. Therefore, ROE is also known as profitability of own capital. Devie et al., (2020) stated that The ratio of net profit to equity is called ROE on ordinary shares, or the return on shareholder investment. Considering the invested capital, the company's value should be used as little as possible.

The effect of a company's financial performance on its investment risk can be very significant. Poor financial performance can cause various risks for a company, including a decline in share value, risk of bankruptcy, and even forced

delisting from the stock exchange. The risk of forced delisting of stock investments can occur due to poor financial performance, inaccurate financial reports, and violations of regulations set by the Indonesian Stock Exchange. Apart from that, poor financial performance can also have a negative impact on company value. A study found that investment performance, financial risk, and company value have a significant influence on the level of company profits (Tseng et al., 2019).

This shows that good financial performance can help increase company value and profitability. However, it is important to remember that the impact of financial performance Depending on a company's unique circumstances, investment risk can change. Thus, the control of financial risk is very crucial in managing the impact of financial performance on the company's investment risk. Effective financial risk management can help companies identify, measure and manage risks related to their financial performance, thereby minimizing their negative impact. Thus, it can be concluded that the company's financial performance has a significant impact on investment risk, company value and profitability. Consequently, it's critical that businesses monitor their financial performance and put in place efficient financial risk management to manage the impact of these investment risks.

RESEARCH METHOD

The literature study or literature review strategy was used in this investigation. A literature review is a thorough summary of research that has been done on a particular subject to show readers what is known and what is unknown, to provide justification for previous study, or to provide ideas for new research (Denney & Tewksbury, 2014). This research in-depth investigates the analysis of the impact of financial performance on company investment risk. Literature analysis involves an in-depth review of the literature and with a strong conceptual foundation, this research makes an important contribution to enriching the discussion regarding the examination of how financial performance affects company investment risk.

RESULT AND DISCUSSION

Definition of Financial Performance

In the dynamic and competitive business world, The financial performance of a business is crucial in the success and sustainability of an organization. Financial performance not only reflects the financial health of a company, but is also an important indicator for management to evaluate

strategies and make the right decisions for the future. Of these, financial performance is among the most crucial things in the business world regarding companies, both internally and externally. When discussing an assessment of a company's performance, financial reports are one of the keys that cannot be forgotten (Cho et al., 2019).

A company's finances are a benchmark for how a company can survive in the future. All financial data will be presented in a performance report. Starting from incoming money and outgoing money reports. So that all financial movements can be monitored clearly. Financial performance describes the performance of a company and can be understood as the outcomes of the different actions taken. An examination of a company's ability to precisely and successfully apply its financial implementation criteria is known as financial performance (Taouab, O., & Issor, Z., 2019). According to Okafor, A., Adeleye, B. N., & Adusei, M. (2021) financial performance is the determination of certain indicators by which the success of an organization or company in generating profits can be measured. Therefore, what needs to be done is to check the financial performance of the financial reports. Financial performance is very important for companies to know and evaluate the company's level of success based on the financial activities carried out.

An organization's, its components', and its personnel' operational effectiveness is evaluated on a regular basis using predefined standards, criteria, and goals. This process is known as performance evaluation. Based on this understanding, it can be said that performance appraisal focuses on how well employees perform as part of the organization based on predetermined standards. Companies must measure financial performance and improve their business operations in an effort to rival other businesses. A more thorough method of calculating, assessing, and resolving a company's financial issues over a given time period is financial performance analysis, which allows performance measurement (Tien et al., 2020).

Financial performance assessment can help a company achieve this goal because it can measure the cost level of various activities carried out by the company, determine or measure how efficient each part, process or production process is, and determine how much profit the company can achieve.

According to Abdel-Basset et al. (2020), a few goals of measuring financial performance are as follows:

1. Ascertain the liquidity level
2. Ascertain the solvency level.
3. Establish the profitability level.

4. Recognize the degree of stability

Appropriate ratio analysis, which compares the figures in the financial report items, is required to determine the precise state of the company's financial performance. When evaluating a company's success, financial performance is the primary determinant, although non-financial indicators like as customer satisfaction, employee productivity, and the development of business activities. Combining these two factors provides a better picture of how the company is doing as a whole.

According to Abou-Foul, M., Ruiz-Alba, J. L., & Soares, A. (2021) financial performance plays an important role in many aspects of company operations, including:

Measuring Success: Financial performance allows a company to measure the overall results achieved over a certain period and assess the contribution of each department to the company's goals.

Strategy Determination: Financial performance analysis provides a strong basis for management to determine future company strategies, such as expansion, diversification, or restructuring.

Decision Making: Financial performance data is an important guide in the decision making process, both at the overall organizational level and at the division or specific division level.

Capital Investment: Good financial performance attracts investors and makes it easier for companies to obtain additional capital thereby increasing efficiency and productivity.

In describing a company's ability to manage finances, it is important to consider several important factors, such as: Profitability, liquidity, solvency and operational efficiency. Understand and evaluate financial metrics related to the factors in question, namely looking for ideas/concepts that will be used to improve financial performance and identifying potential risks that could impact the company's financial health. In the process, measurement of financial performance reports will be very close to performance assessment. With performing measurement or often referred to as financial performance measurement, a company's qualifications and effectiveness can be seen (Zhou, G., Liu, L., & Luo, 2022).

Not only that, by knowing performance measurements first, a company can measure the extent to which a company can operate fully. Then, after knowing the measurements, a company can assess the company's performance in financial terms. So to carry out an assessment, the first step is to know the measurements first.

All of these things are standardization for a company to determine goals, criteria and targets that will be determined. After knowing the size of a company, the company can make improvements to all company operations, especially in terms of finances which are often a problem in building a business partner. Measuring and assessing the company's financial performance is also the starting point for the company to make improvements. That way, the company can increase its effectiveness in operations so that it can compete with its competitor companies. It cannot be denied that the presence of competitors is inevitable. This also provides benefits and challenges. The advantage is that the company can set standards and the level of stability that must be achieved, the challenge is clear: you have to be better than your competitors (Shabbir, M. S., & Wisdom, O. (2020).

If a company has difficulty running its operations to match or exceed its competitors then this will become a quite crucial problem. Because the presence of competitors is a competitor who at any time can threaten the business if it cannot compete well. And the most dangerous thing is that the company can experience business bankruptcy.

Environmental, Social, dan Governance

Increasing awareness around the environment, social and governance has changed the paradigm in the world of business and investment. The acronym ESG, representing Environmental, Social, and Governance, is a concept that is increasingly receiving attention in the world of business and investment. ESG is an abbreviation for Environmental, Social, and Governance, which is a guideline that must be implemented by companies that want to invest by considering components of the environment, society, and governance (Tsang, A., Frost, T., & Cao, 2023). Companies utilize this idea as an assessment tool to assess the social and sustainability impact of their investments. Companies that comply with this standard will integrate these three criteria in their business operations and in their investment decision making.

Basically, this concept grew as a result of investors' awareness of the importance of sustainable business models. This awareness encourages companies to recognize this concept as a crucial guide in the long-term business decision making process.

ESG is an important factor in business and investment because it helps companies manage risk, build reputation and create a positive impact on the environment and society. A deeper understanding of this concept is key to ensuring that companies and investors can contribute to a more sustainable

world. The benefits of implementing ESG according to Lagasio, V., & Cucari, N. (2019) are as follows:

1. Better Risk Management

Companies tend to be able to identify and manage risks more effectively, especially environmental and social risks. This can help avoid adverse legal, financial and reputational consequences.

2. Operational Efficiency

Encouraging companies to improve operational efficiency. For example, waste reduction, energy efficiency and wise use of resources can reduce production and operational costs.

3. Increased Competitiveness

Companies tend to be more competitive. They can attract more customers who care about these issues can attract talent who care about the company's sustainable mission.

4. Increased Employee Engagement

Practices such as diversity and inclusion policies, as well as attention to employee well-being, can increase employee engagement and satisfaction. This can reduce turnover and increase productivity.

5. Better Access to Capital

Investors are increasingly considering when making investment decisions. Companies that prioritize ESG are more likely to gain access to capital from investors who care about sustainability.

Companies that prioritize this typically develop specific policies that follow ESG principles. This includes the company's commitment to environmental sustainability, diversity and inclusion policies, and ethical standards in corporate governance. The company integrates ESG factors in the business decision-making process. This includes assessing environmental and social risks, as well as ensuring that business decisions do not harm environmental sustainability and human rights (Daugaard, D. (2020). Additionally, companies that comply with these standards typically provide transparent reports on their performance. This includes disclosing information about environmental impacts, employment practices, and governance practices. Applying this concept can help companies identify relevant business opportunities, create a company culture that respects ESG values, encourage innovation, and involve employees so that the entire organization understands and supports these principles. Applying this concept to business strategy helps companies achieve sustainability goals, mitigate risk, build a strong reputation,

and support long-term growth. It also ensures that the company contributes positively to the environment, society and good governance. According to Yu, E. P. Y., Van Luu, B., & Chen, C. H. (2020) the challenges in ESG Implementation are as follows:

1. Lack of Awareness and Understanding
One of the main challenges is the lack of adequate awareness and understanding of ESG across organizations. Facing this, companies can organize training for their employees, and also communicate regularly with stakeholders.
2. High Implementation Costs
Implementing these standards requires significant investment, particularly in infrastructure and technology that supports sustainable practices. Addressing this, companies can prioritize sustainable projects with high ROI and look for innovative ways to reduce costs, such as collaborating with partners.
3. Diverse Regulatory Approaches
Companies operating in multiple jurisdictions may face varying regulations, which can be confusing and require significant resources for compliance. Companies must monitor regulations in all relevant jurisdictions and develop systems to efficiently comply with all requirements.
4. Measurement and Reporting Difficulties
Measuring impact in a consistent and measurable way is another challenge. This involves accurate data collection and transparent reporting. Companies need to invest in strong reporting systems and consider the use of technology.
5. Internal Resistance
Some employees or stakeholders may be resistant to change. To address this, companies need to build support from the top down, ensuring stakeholders understand the long-term benefits.

Facing these challenges, companies need to take a holistic and sustainable approach in implementing ESG. With strong commitment, education and wise strategies, many challenges in ESG implementation can be overcome.

The Influence of Environmental, Social and Governance on Financial Performance

According to the principles of legitimacy theory, companies seek to develop relationships with environmental, social and governance aspects in an effort to gain recognition for the activities they carry out (Minutolo et al., 2019). This disclosure will provide information about returns on investment that can be sustainable for the business. The purpose of this ESG report is to help the organization create financial value by highlighting opportunities to save expenses, increase returns, and lower risks through improved communications with stakeholders and shareholders.

In conventional practice, profit and other financial indicators are the most important thing, although currently assessing a company's performance no longer relies solely on financial indicators. Alkaraan et al., (2022) stated that company performance assessments using a balanced scorecard have developed to include assessments of environmental and social performance. Furthermore, Alkaraan et al., (2022) also stated that the failure of a company to adequately produce good performance in protecting the environment and the social sector can cause the company to be at high risk in providing future value to its shareholders. Global rating agencies including Standard & Poor's, Bloomberg, and Fitch have evaluated how well companies have performed in the environment, social responsibility, and governance (ESG) domain. Based on the IDX ESG Leaders index guidelines (November 2020) Sustainalytics is an ESG risk assessment institution trusted by the Indonesian Stock Exchange to provide ESG risk values for issuers listed on the Indonesian Stock Exchange. Research conducted by Duque-Grisales, E., & Aguilera- Caracuel, J. (2021) states that ESG ratings have a positive impact on company financial performance. Almeyda (2019) produced research which stated that ESG disclosure had a significant positive influence on a company's financial performance, namely ROA (Return on Assets) and ROC (Return on Capital). This research was conducted using an ESG risk approach and its impact on the return on assets (ROA) of the company. The purpose of this study is to determine whether a company's financial performance is impacted by ESG risk.

The Impact of Financial Performance on Company Investment Risk

In the current globalization-era business environment, there is fierce competition amongst companies to boost their operational profits. As a result, these companies are striving to enhance their performance in order to attract investors and raise share prices. Especially in the domestic manufacturing

industry sector which is currently in the low category. This is due to continued fluctuations in the rupiah, and the effects of the trade war which has resulted in a flood of cheap industrial products from China. This creates tight business competition in the country, amidst weak public demand. Investors might utilize financial performance data to choose whether to stick with their investment in the company or explore other options. A corporation with strong financial performance will have a high business value. Alternatively, share prices could be expressed as a function of corporate value. Investors' assessment of a firm's success, or corporate value, is frequently correlated with share prices (Devie et al., 2020).

Additionally, the company's high valuation inspires trust in the market regarding both the company's success to date and its prospects for the future. By examining the business's financial reports, investors can decide whether or not to invest in the company. Investors who will invest in this matter by knowing the investment risks can provide confidence in investing their capital in the company and can immediately overcome them if possible risks occur. Risks can occur due to ignorance about these risks which can cause losses for investors themselves. In this way, investors will take into account risks and losses so that these risks can be overcome immediately. The level of risk included in the investment assessment will influence the size of the returns expected by investors. When a firm makes a budgeted investment that has a high degree of risk, investors who put their money into that investment demand or expect large returns, and vice versa. Indeed, there is only one way that return and risk are related. The outcomes are higher the greater the risk. On the other hand, the lesser the risk, the lower the needed or achieved results. In other studies that were carried out by Widagdo et al., (2020) concluded that the leverage ratio can be used as an indicator in predicting stock systematic risk, the higher the leverage ratio predicts an increase in stock systematic risk. In the meantime, financial ratios which are represented by the price-earnings ratio, debt to total assets, and asset growth have a major impact on systemic risk.

The importance of sustainability performance aspects for companies has increased investors' attention to gain a level of confidence that companies can operate over a long period of time and can meet the interests of shareholders. The sustainability aspect has dimensions of environmental, social and governance performance which are important components for protecting companies from short-term opportunistic interests that can threaten company value. This research aims to examine the implications of aspects of corporate sustainability performance, as measured by ESG information, on the level of

corporate risk. According to Ekinci, R., & Poyraz, G. (2019) in their research, they explain that signaling theory supports research related to signals or company responses regarding

Information released by the company because of its influence on investment decisions. Investors and businesspeople use this information, which takes the shape of management's actions, as supplementary data that paints a picture of the company's past, present, and future circumstances for its sustainability as well as the consequences or risks it will take. Barauskaite, G., & Streimikiene, D. (2021) explained that information provided by management is used as a sign that reflects a signal in the form of positive or negative news. The research results prove that environmental information and governance information have an influence on the company's systematic risk level, but do not have an influence on the company's total risk level. Apart from that, the disclosure of social information has been empirically proven to have an influence on the level of total risk, systematic risk and non-systematic risk of the company. This proves that the higher the company's sustainability performance can reduce the level of company risk. Reducing these obstacles can reduce systematic risk. However, in contrast to research conducted by Chen, Z., & Xie, G. (2022), no strong evidence was found to support the relationship between environmental disclosure and systematic risk. The results of this research are in accordance with signaling theory which states that environmental, social and governance disclosures can provide signals or responses for investors. Companies that disclose more about ESG issues in their sustainability reports indicate that corporate activities are environmentally responsible. Signaling theory states that disclosure provides a positive signal to investors or other external parties. This research was conducted to have a positive impact on all stake holders who have an interest in the company. Especially for investors, creditors and the surrounding community. Because from the research it can be concluded that companies that have high ESG disclosure scores tend to have low risk and have good company performance.

CONCLUSION

The impact of financial performance on a company's investment risk can be very significant. Poor financial performance can cause various risks for a company, including a decline in share value, risk of bankruptcy, and even forced delisting from the stock exchange. Company investment risks can occur due to poor financial performance, inaccurate financial reports, and violations of regulations set by the Indonesian Stock Exchange. Apart from that, poor

financial performance can also have a negative impact on company value. A study found that investment performance, financial risk, and company value have a significant influence on the company's profit level.

This shows that good financial performance can help increase company value and profitability. Effective financial risk management can help companies identify, measure and manage risks related to their financial performance, thereby minimizing their negative impact. Thus, it can be concluded that the company's financial performance has a significant impact on investment risk, company value and profitability. Consequently, it's critical that businesses focus on their financial performance and implement effective financial risk management to manage the impact of these investment risks.

ESG is an important factor in business and investment because it helps companies manage risk, build reputation and create a positive impact on the environment and society. A deeper understanding of this concept is key to ensuring that companies and investors can contribute to a more sustainable world.

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