e-ISSN 2746-5667
5th INTERNATIONAL CONFERENCE ON BUSINESS & SOCIAL SCIENCES
RESPONSIBLE AI AND HUMAN-CENTERED DESIGN: BRIDGING ETHICS AND INNOVATION

EXPLORING ESG AND FINANCIAL PERFORMANCE: LEVERAGE AS MODERATOR IN THE INDONESIAN CONSUMER NON-CYCLICAL SECTOR

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Abstract: This study examines the impact of Environmental, Social, and Governance (ESG) Practices on financial performance, moderated by leverage in Indonesia's consumer non-cyclicals sector. Prior research presents contradictory findings and limited exploration of leverage as a moderating variable, particularly in the consumer non-cyclicals sector. Using purposive sampling, seven (7) companies consistently reported ESG Scores from 2020 to 2024 were selected. Panel regression analysis with a fixed effect model was employed. The test shows a significant negative effect of ESG and leverage (as proxy by Debt Equity Ratio/DER) on financial performance (as proxy by ROA). Furthermore, leverage moderates the impact of ESG on financial performance. From this result, this study suggests that firms must carefully balance their ESG implementation commitments with their capital structure. A high level of leverage can increase the risk of corporate losses. Companies need to align their ESG implementation strategies with corporate sustainability by ensuring long-term value creation.

Keywords: financial performance, ESG, leverage, consumer non-cyclicals sector

1. Introduction

The global business environment is becoming more complicated and competitive for modern enterprises. One of the main objectives is still to achieve sustainable profitability. Return on Assets (ROA), a common metric for measuring profitability, shows how well a business uses its resources to turn a profit (Brigham & Houston, 2019). A high level of profitability not only indicates a company's financial performance but can also be attractive to investors.

Achieving corporate profitability is not only driven by operational performance but also influenced by non-financial performance through ESG practices. ESG practices demonstrate a company's commitment to Environmental, Social, and Governance (ESG) aspects. By cultivating a positive reputation, strengthening consumer loyalty, and mitigating long-term risks, strong ESG performance ultimately serves as a critical foundation for enhancing long-term profitability and ensuring corporate resilience (Han & Jo, 2024).

This study focuses on non-cyclical consumer sector companies listed on the IDX. These firms provide essential goods and services for daily needs, which results in a relatively stable demand that is less susceptible to economic cycles. However, this very stability fosters intense competition within the sector. Furthermore, companies must navigate a regulatory landscape in Indonesia that mandates responsible business conduct. For instance, the Regulation No. 51/POJK.03/2017 obligates financial institutions and issuers to adopt sustainable finance principles and publish sustainability reports (Otoritas Jasa Keuangan, 2017). Similarly, Law No. 13 of 2003 concerning Manpower, which underscores workers' rights and occupational safety (BPK RI, 2003) compels companies to prioritize employee welfare. These regulations collectively incentivize businesses to integrate environmental, social, and governance (ESG) considerations into their operations. Nevertheless, the critical question of whether such ESG implementation tangibly enhances a company's financial performance remains a subject for empirical investigation.

Empirical research on the relationship between ESG implementation and corporate performance has contradictory findings across different industries and countries. Studies by Alareeni & Hamdan (2020); Han & Jo (2024) demonstrate a significant positive influence of ESG practices on operational performance, as measured by Return on Assets (ROA). These studies posit that firms with high ESG ratings cultivate a stronger reputation and are better positioned to attract sustainability-conscious investors, thereby supporting long-term stock value and enhancing financial performance. Conversely, other research, such as that by (Duque-Grisales & Aguilera-Caracuel, 2021; Nareswari et al., 2023) reports a negative relationship, arguing that the substantial initial investments required for ESG initiatives can diminish short-term profitability and adversely affect ROA. Meanwhile, a separate body of work, including studies by (Buallay, 2022; Thomas et al., 2021) found no statistically significant link between ESG adoption and operational performance (ROA). This lack of consensus underscores the ongoing debate regarding the tangible financial returns on ESG investments.

In addition to ESG, this study incorporates leverage, measured by the Debt-to-Equity Ratio (DER), and liquidity, measured by the Current Ratio (CR). DER illustrates a company's capital structure and its level of financial risk, while CR indicates its ability to meet short-term obligations (Ross et al., 2022). The inclusion of these variables is critical, as high debt can enhance financial leverage through the tax shield benefit, yet it also burdens the firm with substantial interest costs, a central tenet of the trade-off theory (Myers, 1984) Similarly, high liquidity ensures operational smoothness but may also signal the holding of unproductive assets that can potentially reduce profitability (Deloof, 2003). Furthermore, this research includes firm size as a control variable. Larger firms typically benefit from economies of scale, which can augment profitability. However, they may also be subject to bureaucratic inefficiencies that can negatively impact performance. Finally, this study introduces a novel dimension by examining DER as a moderating variable in the relationship between ESG performance and ROA. This aims to determine whether a company's leverage influences the strength or direction of the ESG-financial performance link.

Based on the foregoing discussion, this study aims to examine the influence of ESG, DER, CR, and Firm Size on profitability (ROA) and to investigate the moderating role of DER in the relationship between ESG and ROA within non-cyclical consumer sector companies listed in IDX.

2. Literature Review

Stakeholder Theory

Stakeholder theory, as developed by (Freeman, 1984) stated that a company's success is intricately linked to the interests of its various constituents, including shareholders, employees, suppliers, creditors, and the local community with which it has direct business relations. In the contemporary business environment, this principle has translated into stringent reporting frameworks for Environmental, Social, and Governance (ESG) matters. Consequently, companies are increasingly adopting comprehensive ESG reporting not only as a strategic initiative but also in direct response to mounting pressure from both their stakeholders and regulatory authorities

e-ISSN 2746-5667

By addressing stakeholder interests and demands through ESG implementation, a company can secure support from both internal and external groups, cultivate a stronger reputation, and mitigate operational uncertainties. These combined effects ultimately contribute to sustaining long-term corporate profitability (Velte, 2017).

Agency Theory

Agency Theory examines the relationship and potential conflicts of interest between a company's owners (principals) and its management (agents). According to Jensen & Meckling, (1976), agency conflict is mitigated when managerial and stakeholder interests are aligned, supported by robust internal control mechanisms instituted by owners to curb opportunistic managerial behavior. In this framework, management is compelled to make decisions that extend beyond short-term financial gains to encompass the firm's long-term sustainability. The effective implementation of Environmental, Social, and Governance (ESG) principles serves as a tangible demonstration that management is acting in the owners' long-term interests, thereby reducing potential risks and enhancing corporate reputation.

Legitimacy Theory

Legitimacy Theory states that, to maintain its existence, a company must align its activities with the values and norms of the society in which it operates. This theory states that a company must demonstrate its contribution to the society in which it operates and meet societal expectations to ensure its legitimacy and ensure sustainable access to resources (Hahn & Kühnen, 2013). Contributions made by a company to the society in which it operates can enhance its image and reputation (Parguel et al., 2011). Legitimacy can change over time and with changing values in society. Therefore, for a company's business to be sustainable, it must be adaptive to changing societal needs. Companies must be able to adapt to shifting social expectations (Martens & Bui, 2023). The implementation of ESG is one way a company can achieve social legitimacy.

Financial Performance

Financial performance describes a company's financial condition over a specific period, reflecting the results of operational activities carried out by utilizing its resources to generate profits (Nugroho & Hersugondo, 2022). In this study, financial performance is calculated using ROA. ROA can assess a company's ability to generate profits from its assets (Situmorang, 2023).

$$Return\ on\ Assets = \frac{Earning\ After\ Tax}{Total\ Assets}$$

Environmental, Social, and Governance **(ESG)**

The ESG score reflects a company's long-term performance, considering environmental, social, and governance factors. Environmental, Social, and Governance (ESG) is a non-financial approach used by companies to strengthen sustainability by considering environmental, social, and governance aspects. Implementing ESG principles can help companies improve efficiency, manage risk, and gain stakeholder trust. Investors can also make decisions based on overall performance rather than solely relying on financial success if ESG is incorporated into a company's investment decisions (Mohammad & Wasiuzzaman, 2021).

ESG encompasses three main pillars. The first pillar, environmental responsibility, relates to carbon emission reduction practices and efficient resource utilization. The second pillar, social aspects, encompasses managing relationships with employees, customers, and the community. The third pillar, governance, encompasses transparent and accountable leadership practices and decision-making structures (Friede et al., 2015). This study used ESG score data obtained from Refinitiv.

***Current Ratio* (CR)**

CR is a company's liquidity ratio that measures the company's ability to meet its current liabilities using its current assets (Syahpoetri & Suhartono, 2024).

$$Current\ Ratio = \frac{Current\ Assets}{Current\ Liabilities}$$

***Debt to Equity Ratio* (DER)**

DER is a leverage ratio that measures how much of a company's funding comes from debt compared to its capital (Syahpoetri & Suhartono, 2024).

$$Debt\ to\ Equity\ Ratio = \frac{Total\ Liabilities}{Total\ Equity}$$

***Firm Size* (SIZE)**

Firm size is a scale that indicates the size of a company (Indrawan et al., 2020). This study uses the natural logarithm of total assets to measure firm size (Nareswari et al., 2023).

$$Firm\ Size = LN\ (Total\ Assets)$$

Hypothesis Development

ESG reporting is one way companies strive to be competitive. Environmental, Social, and Governance (ESG) indicators are increasingly important as measures of corporate sustainability and attractiveness to investors. Previous research has shown that sound ESG implementation can enhance a company's reputation and positively impact financial performance (Giese et al., 2019). ESG plays a crucial role in building stakeholder trust and loyalty. This is reinforced by the research findings of Alareeni & Hamdan (2020) , which found that ESG has a positive and significant impact on financial performance. Providing detailed ESG information (environmental, social, and governance factors) in company reports can provide information for companies to make management decisions, along with other stakeholders. A study by Nugroho & Hersugondo (2022) also suggests that ESG has a positive impact on financial performance. Higher ESG scores indicate a company's ability to achieve good financial performance . Therefore, the first hypothesis of this study is:

H1: ESG has a positive impact on the company's financial performance

DER indicates the extent of debt used compared to a company's equity to finance its assets. Increasing debt leads to increased interest expenses, which can reduce the company's profits. Declining profits due to high debt interest rates can lead to a decrease in ROA (Putri & Kusumawati, 2020; Situmorang, 2023). Therefore, the second hypothesis of this study is:

H2: DER has a negative impact on the company's financial performance

CR is a ratio of current assets to current liabilities. A higher CR indicates that the company has increasing current assets compared to its short-term liabilities. A larger number of current assets makes it easier for the company to pay off debt and manage its current assets, thus increasing profits. Increasing company profits indicates an increase in the company's financial performance. This statement is supported by the results of studies conducted by Mahardhika & Marbun (2016) dan Zarkasyi et al. (2021). Therefore, the third hypothesis of this study is:

H3: CR has a positive impact on the company's financial performance

The larger a company, the easier it is to obtain additional external capital to expand its performance and increase its profits. Company size, as measured by its assets, also indicates the amount of assets held. Therefore, with a large number of assets, a company will have greater flexibility in managing its assets to maximize profits. This increase in profit can also increase ROA (Oktavia & Titiek, 2022; Susanto, 2022). Therefore, the fourth hypothesis of this study is:

H4: Firm Size has a positive impact on the company's financial performance

Slack resource theory states that companies with high debt burdens tend to have limited resources to optimally implement ESG strategies (Daniel et al., 2004; Wally & Fong, 2000). Under conditions of high leverage, companies tend to deprioritize sustainability initiatives due to their focus on meeting short-term financial obligations. Conversely, companies with a healthy financial structure have the leeway to invest in ESG activities, which in turn improves their financial performance. Based on this description, the fifth hypothesis of this study is:

H5: DER negatively moderates the positive influence of ESG on the company's financial performance

3. Method

This study examines the factors influencing the financial performance of consumer non-cyclical sector companies listed on the Indonesia Stock Exchange (IDX) for the 2020-2024 period. Purposive sampling was used to select companies listed on the IDX, possess ESG data, and publish complete financial statements for the 2020-2024 observation period. Seven companies were sampled over a 5-year observation period, resulting in 35 observations. The data analysis method used was panel data regression analysis using EViews.

Table 1. Sample

No.	Company
1.	Astra Agro Lestari Tbk PT
2.	Astra International Tbk PT
3.	Charoen Pokphand Indonesia Tbk PT
4.	Gudang Garam Tbk PT
5.	Indofood CBP Sukses Makmur Tbk PT
6.	Indofood Sukses Makmur Tbk PT
7.	Unilever Indonesia Tbk PT

4. Result and Discussion

Result

The Chow test results show a probability value of 0.000 < sig. value (0.05), so the most suitable model between the Common Effect Model (CEM) and the Fixed Effect Model (FEM) is FEM. Then, it is continued with the Hausman test to select the most suitable model between the Random Effect Model and FEM.

Table 2. Chow Test

Effects Test	Stat.	d.f.	Prob.
Cross-section F	15.955060	(6.23)	0.0000
Cross-section Chi-sq	57.447629	6	0.0000

Source: Eviews 13 (2025)

Table 3. Hausman Test Result

Test Summary	Chi-Sq. Stat.	d.f.	Prob.
Cross-sec. random	19.224958	5	0.0017

Source: Eviews 13 (2025)

The results of the Hausman test show a probability value of 0.0017 < sig. value (0.05), the selected model is FEM.

Table 4. FEM Panel Data Regression

Variable	Coeff.	SE	t-Stat.	Prob.
C	-4.092993	1.749693	-2.339263	0.0284
ESG Score	-0.005185	0.001628	-3.185236	0.0041
DER	-0.497250	0.174991	-2.841574	0.0092
ESG *_DER	0.005781	0.002304	2.509197	0.0196
CR	0.004470	0.010102	0.442420	0.6623
SIZE	0.140825	0.056207	2.505481	0.0198
Adjusted R-squared	0.920763			
Prob(F-statistic)	0.000000			

Source: Eviews 13 (2025)

By using FEM, the regression equation for this study is:
ROA = -4.092993 -0.005185 ESG Score -0.497250 DER + 0.005781 ESG * DER + 0.004470 CR + 0.140825 SIZE + e

The regression equation results show that the ESG regression coefficient is -0.005185 and the DER regression coefficient is -0.497250, meaning ESG and DER have a negative effect on profitability as measured by ROA in non-cyclical consumer sector companies. The probability value for the effect of ESG Score on ROA is 0.0041 and the probability for the effect of ESG Score on ROA is 0.0092, which is smaller than the p-value of 0.05. This test result indicates that there is a significant negative effect of ESG and DER on ROA. Likewise, the test results for the firm size variable show a regression coefficient value of 0.140825 with a probability value of 0.0198. These results indicate that firm size has a positive effect on company profitability. Meanwhile, the CR test results produce a regression coefficient value of 0.004470 with a probability value of 0.6623. These results indicate that CR does not have a significant effect on ROA. In addition, DER can strengthen the negative effect of ESG on ROA. With an ESG and DER interaction coefficient value of 0.005781 and a probability value of 0.0198.

The adjusted R^2 value is 0.920763, or 92.0763%. This indicates that the ESG, DER, CR, SIZE, and ESG-DER interaction variables can explain 92.0763% of the impact on the profitability of non-cyclical consumer sector companies. The remaining 7.9237% can be explained by other variables outside the model.

Discussion

The Influence of ESG on Probability

The results of the hypothesis test indicate a significant negative effect of ESG on the profitability of non-cyclical consumer sector companies in Indonesia. These test results indicate that ESG implementation can negatively impact a company's profitability. This finding aligns with a study by (Nareswari et al., 2023) which examined non-financial companies listed on the Indonesia Stock Exchange (IDX). Although ESG is often associated with improved reputations and long-term sustainability for companies implementing ESG, ESG implementation requires significant investment, such as replacing technology with environmentally friendly machinery and building waste management systems. Furthermore, ESG implementation requires high costs for training, operational changes, and social activities, which can increase company costs. While funds allocated to ESG activities may provide long-term benefits by increasing stakeholder trust and mitigating risks, in the short term, the increased revenue generated is insufficient to cover the costs of ESG investments.

The Influence of DER on Probability

The results of the hypothesis test on the effect of DER on profitability also show a negative and significant effect of DER on the profitability of non-cyclical consumer sector companies in Indonesia. This finding indicates that lower debt will increase profitability and vice versa. This finding aligns with several research findings in Indonesia, (Putri & Kusumawati, 2020; Situmorang, 2023) in the food and beverage industry; advertising, printing, and media; and research in South Africa (Chininga & Alhassan, 2024) on companies listed on the Johannesburg Stock Exchange, which also showed a negative and significant effect of DER on ROA. The use of debt can incur fixed interest expenses and increase risk, characterized by an increase in the cost of debt (Putri & Puspawati, 2023). An increase in DER accompanied by increased risk will lead to a decrease in ROA because the debt obtained by the company is not utilized effectively in asset investments that can increase revenue-generating capabilities sufficient to cover the cost of debt, resulting in a decrease in ROA (Chininga & Alhassan, 2024).

The Influence of CR on Probability

The results of the hypothesis test on the effect of CR on profitability indicate no significant effect. High liquidity does not necessarily increase company profitability. Excessive liquidity may result in a large amount of idle current assets, such as cash and inventory, so increased liquidity does not significantly impact ROA. This finding aligns with studies (Akib et al., 2022; Alfiani, 2022; Syahpoetri & Suhartono, 2024) that found no effect of CR on ROA.

The Influence of Firm Size on Probability

The results of the hypothesis test on the effect of firm size on profitability indicate a positive and significant effect of firm size on the profitability of non-cyclical consumer sector companies in Indonesia. Larger companies tend to be able to take advantage of economies of scale (Anggraeni & Harnanik, 2015; Velte, 2017), thereby reducing operational costs and increasing profitability (Maryadi & Dermawan, 2019; Sidauruk & Fadilah, 2020). These findings align with those of (Oktavia & Titiek, 2022; Susanto, 2022), which also found a positive effect of firm size on ROA.

DER Moderates the Effect of ESG on Profitability

The results of the hypothesis test on the moderating effect of ESG on ROA indicate that DER can amplify the negative effect of ESG on ROA. This finding contributes to the importance of capital structure management, so that the need for funds for investment in ESG implementation, with increased debt, can exacerbate the negative impact of ESG on ROA. ESG implementation, especially in developing countries, requires allocation of time and resources, which can increase interest expenses (Kalia & Aggarwal, 2023). The condition of ESG implementation in non-cyclical consumer sector companies in Indonesia shows that the costs of ESG implementation are high and the benefits are not yet visible. Therefore, increasing debt increases company risk and can exacerbate the decline in profitability from ESG implementation.

5. Conclusions

The results of this study conclude that ESG and DER have a significant negative effect on profitability. Firm size has a significant positive effect on profitability. The current ratio does not significantly affect profitability. DER can amplify the negative effect of ESG on ROA in non-cyclical consumer sector companies in Indonesia listed on the IDX. The implication of this study's findings is that companies must carefully balance their ESG implementation commitments with their capital structure. High leverage can increase the risk of corporate losses. Companies need to align their ESG implementation strategies with corporate sustainability by ensuring long-term value creation.

Acknowledgements

The author gratefully acknowledges Maranatha Christian University for the funding and support provided in carrying out this research.

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ICOBUSS INTERNATIONAL CONFERENCE ON BUSINESS & SOCIAL SCIENCES
e-ISSN 2746-5667

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