



ESG Performance on Corporate Financial Outcomes: Evidence from Indonesian Firms in the SRI-KEHATI Index

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Abstract. This study explores the relationship between Environmental, Social, and Governance (ESG) performance and corporate financial performance in Indonesia, focusing on publicly listed companies included in the SRI-KEHATI Index. Using panel data from 10 firms over the period from 2015 to 2020, the research employs a multiple regression model to assess the impact of ESG performance on Return on Assets (RoA), with leverage, industry sector, and GDP growth as control variables. The findings reveal a statistically significant positive relationship between ESG performance and financial performance, indicating that firms with stronger ESG practices tend to achieve higher profitability. Additionally, leverage and industry sector are identified as important determinants of financial performance, with capital structure and sector-specific factors significantly influencing corporate profitability. Although the study provides meaningful insights, it acknowledges limitations such as the small sample size and the binary measure of ESG performance. Future research should focus on more granular ESG metrics and larger sample sizes to enhance the robustness of the findings. The results offer valuable implications for investors and policymakers, underscoring the importance of integrating ESG considerations into corporate strategy to drive financial success and promote sustainable development.

Keywords: ESG Performance, Corporate Financial Performance, Return on Assets, Sustainability, GDP Growth.

1 Introduction

The increasing global focus on sustainability has led to a growing recognition of the role of Environmental, Social, and Governance (ESG) factors in driving corporate success. ESG has evolved from being a peripheral concern to becoming a central component of corporate strategy, particularly in response to heightened expectations from stakeholders, including investors, regulators, and consumers [18,2]. In recent years, the demand for companies to demonstrate their commitment to sustainable practices has intensified, with firms increasingly required to integrate ESG principles into their operations to ensure long-term value creation [24]. In parallel, sustainable finance, which emphasises investments that account for environmental and social considerations, has gained momentum, with investors showing a clear preference for

firms that adhere to ESG principles [2]. This shift reflects broader societal concerns about climate change, corporate governance, and social responsibility, all of which are crucial for ensuring the sustainability of both businesses and economies [26].

In the context of emerging markets, such as Indonesia, the relevance of ESG has become even more pronounced [22]. Emerging economies, which are often characterised by rapid industrial growth and resource dependence, face unique sustainability challenges [21]. These challenges include balancing economic development with environmental protection and ensuring that social welfare is not compromised by corporate practices [15]. As a result, firms operating in emerging markets are under growing pressure to adopt ESG practices that align with global sustainability goals [7]. Indonesia, in particular, has made significant strides in promoting ESG through initiatives such as the SRI-KEHATI Index, which benchmarks companies based on their sustainability performance [19]. Despite these developments, the relationship between ESG performance and corporate financial outcomes in emerging markets remains underexplored, particularly when compared to more developed economies [6].

The existing literature on ESG has largely focused on firms in developed markets, where the integration of ESG factors into corporate decision-making is more advanced [12]. Numerous studies have demonstrated the positive impact of ESG on financial performance, with evidence suggesting that firms with strong ESG practices enjoy benefits such as enhanced reputation, improved operational efficiencies, and reduced regulatory risks [13,14]. However, the findings in developing economies are less conclusive, as firms in these regions may face different regulatory environments, market conditions, and stakeholder pressures [15]. Additionally, studies have often overlooked the sectoral differences that could influence the effectiveness of ESG practices [16]. For instance, while certain sectors, such as energy and manufacturing, are particularly exposed to environmental risks, other sectors, such as banking or consumer goods, may be more affected by governance or social issues [4]. As such, there is a need for more nuanced studies that account for these sectoral variations and consider the unique dynamics of emerging markets [27].

A key research gap thus exists in understanding how ESG performance impacts financial outcomes in the context of emerging markets and how this relationship may vary across different industries [19]. While some research has been conducted in developed markets, the evidence in emerging economies, particularly Indonesia, is limited [17]. Given Indonesia's rapid economic development, its diverse industrial base, and its commitment to sustainability through initiatives like the SRI-KEHATI Index, the country provides an ideal context to investigate these dynamics [21]. Furthermore, the role of leverage and macroeconomic conditions, such as GDP growth, in shaping the relationship between ESG and financial performance remains underexplored [20]. Firms in emerging markets often operate under different financial constraints compared to their counterparts in developed economies, which may influence how leverage impacts profitability in the presence of strong ESG practices [23].

The objective of this study is to address these gaps by examining the relationship between ESG performance and financial performance in Indonesia, with a focus on companies included in the SRI-KEHATI Index. Specifically, this research seeks to determine whether companies with strong ESG practices, as indicated by their

inclusion in the SRI-KEHATI Index, experience improved financial performance [24]. In addition, the study aims to investigate the role of leverage and industry sector in moderating this relationship, as well as the potential influence of macroeconomic factors, such as GDP growth [3]. By focusing on Indonesia, this study provides valuable insights into the financial implications of ESG in emerging markets, where the balance between sustainability and profitability is becoming increasingly critical [26]. Moreover, this research contributes to the broader literature by exploring how industry-specific factors shape the financial outcomes of ESG investments, offering practical implications for investors and policymakers in emerging markets [27].

2 Literature Review

The relationship between Environmental, Social, and Governance (ESG) performance and financial performance has garnered significant attention in the corporate finance literature over the past decade. Numerous empirical studies suggest that strong ESG practices can positively influence firm value and profitability. Eccles et al. [18] argue that firms with robust ESG practices experience improved operational efficiencies and lower risk exposure, which in turn lead to higher financial returns. These firms are better able to manage their resources, reduce waste, and optimise energy use, all of which contribute to lower operational costs and enhanced profitability. Additionally, ESG-compliant firms often enjoy enhanced stakeholder relationships, which can improve their reputation and lead to increased customer loyalty, better access to capital, and favourable regulatory treatment [1]. ESG performance has also been linked to risk mitigation.

Companies with strong ESG practices are better positioned to avoid environmental accidents, governance failures, or social controversies, which can result in substantial financial and reputational costs [24]. Fatemi et al. [2] demonstrate that firms with high ESG scores tend to have lower capital costs, as investors perceive these firms to be less risky and more sustainable in the long term. Friede et al. [13], in their comprehensive meta-analysis of over 2,000 studies, find that the majority of the literature reports a positive relationship between ESG and financial performance, with only a minority of studies showing a negative or neutral effect. The authors conclude that integrating ESG factors into corporate decision-making can enhance financial performance by improving resource allocation, reducing risks, and fostering long-term value creation.

However, some scholars caution that the relationship between ESG and financial performance is not always straightforward. While the general consensus leans towards a positive association, several studies point out that the impact of ESG can vary across sectors and regions. Chava [22] contends that in certain capital-intensive industries, such as energy or manufacturing, the upfront costs associated with adopting ESG practices may outweigh the immediate financial benefits. Similarly, Waddock and Graves [21] suggest that firms operating in highly regulated environments may already comply with strict environmental or governance standards, making further investments in ESG less impactful on financial outcomes. These conflicting findings highlight the importance of considering sectoral and regional variations when analysing the ESG-financial performance nexus.

Leverage, defined as the proportion of a firm's assets financed by debt, is another critical factor that influences corporate financial performance. According to traditional corporate finance theory, the use of debt can enhance profitability by reducing the firm's cost of capital and allowing for tax shields on interest payments [13]. The Modigliani-Miller theorem posits that, under certain conditions, an optimal capital structure can maximise a firm's value by balancing the benefits of debt financing with the associated risks of financial distress [7]. Empirical evidence largely supports the notion that leverage can positively influence financial performance, provided it is managed effectively. Rajan and Zingales [19], in their study of international capital structures, find that leverage enhances firm profitability in contexts where firms can use debt to finance growth opportunities or take advantage of tax deductions. However, they also note that excessive leverage can lead to financial distress, particularly during periods of economic downturn. Firms with high debt levels may face challenges in servicing their debt obligations, which can result in liquidity problems and, in extreme cases, bankruptcy [6]. In the context of emerging markets, firms often rely on leverage to finance expansion in industries where access to capital is limited. However, the high cost of borrowing and currency volatility in these markets may increase the risks associated with debt financing [12].

In the context of ESG, recent studies suggest that firms with strong ESG performance are better equipped to manage leverage. Friede et al. [13] argue that ESG-compliant firms tend to have lower default risks and better credit ratings, allowing them to access cheaper financing and manage their debt more effectively. In contrast, firms with poor ESG practices may struggle to raise capital and face higher borrowing costs, which can negatively affect their financial performance. The impact of industry sector on financial performance and the effectiveness of ESG practices has been widely discussed in the literature. Different sectors face unique challenges and opportunities in integrating ESG factors into their operations, leading to varying financial outcomes. For example, energy and manufacturing firms are typically more exposed to environmental risks, such as pollution or resource depletion, and thus stand to benefit significantly from improving their ESG practices [13]. Firms in these sectors often face stringent environmental regulations and higher compliance costs, but by adopting sustainable practices, they can reduce their regulatory burdens and enhance their long-term competitiveness.

On the other hand, service-oriented sectors, such as banking or consumer goods, may derive greater value from improving their governance or social responsibility practices [14]. Banks, for example, are increasingly adopting responsible lending practices, which align their portfolios with sustainable development goals and mitigate credit risks associated with environmentally or socially harmful investments. Similarly, consumer goods companies may benefit from improved brand loyalty and customer satisfaction by adopting ethical sourcing practices or reducing their carbon footprints [10]. The industry-specific impact of ESG practices underscores the importance of tailoring sustainability strategies to the unique characteristics of each sector. Furthermore, Velte [16] suggests that industry-specific characteristics, such as capital intensity, competitive dynamics, and regulatory pressures, play a crucial role in shaping the financial benefits of ESG. In highly competitive industries, firms that are early adopters of ESG practices may gain a first-mover advantage, while firms in

heavily regulated sectors may find that complying with ESG standards is more a matter of survival than a source of competitive advantage.

In addition to firm-specific and sector-specific factors, macroeconomic conditions, such as GDP growth, inflation, and interest rates, also play an important role in influencing financial performance and the effectiveness of ESG strategies. Studies show that during periods of economic growth, firms are better able to invest in sustainability initiatives, as they have access to greater financial resources and face lower constraints on their budgets [4]. Conversely, during periods of economic downturn, firms may cut back on ESG investments to focus on short-term survival and liquidity management [27]. Moreover, macroeconomic factors can shape investor sentiment towards ESG practices. For instance, during times of economic uncertainty, investors may prioritise stability and risk mitigation, which can lead to a preference for firms with strong ESG performance, as these firms are perceived to be more resilient and better able to navigate turbulent market conditions [23]. El Ghouli et al [23] provide evidence that firms in countries with stronger macroeconomic fundamentals tend to have higher ESG scores, suggesting that macroeconomic stability plays a key role in facilitating the adoption of sustainable business practices.

The impact of macroeconomic conditions on ESG-financial performance relationships is particularly relevant in emerging markets, where economic volatility and institutional weaknesses may hinder firms' ability to fully reap the benefits of their ESG investments [21]. In these contexts, firms may face higher borrowing costs, regulatory uncertainty, and political risks, which can limit their capacity to invest in sustainability initiatives [20]. Consequently, understanding the interplay between firm-level ESG practices, sector-specific factors, and macroeconomic conditions is critical for assessing the financial implications of ESG in emerging markets. This highlights the need for further research that considers these multifaceted influences on financial performance, particularly in the context of economies undergoing rapid industrialisation and facing unique sustainability challenges.

3 Methodology

This study adopts a quantitative research design and employs panel data collected from 10 publicly listed companies in Indonesia over a six-year period, from 2015 to 2020. The companies were selected based on their inclusion in the SRI-KEHATI Index, a recognized benchmark for sustainable and responsible investing in Indonesia [23]. Financial performance data, including return on assets (RoA), was sourced from the Indonesia Stock Exchange (IDX), while leverage ratios were derived from company financial reports [9]. ESG performance was measured through a binary variable, where inclusion in the SRI-KEHATI Index was assigned a value of one, and non-inclusion was coded as zero. Macroeconomic data, specifically Indonesia's annual GDP growth rates, was obtained from Bank Indonesia to capture broader economic influences on company performance [3].

In this study, the dependent variable is financial performance, measured through RoA, which reflects a company's profitability relative to its assets. The primary independent variable, ESG performance, is operationalized as a binary variable to represent whether a company is included in the SRI-KEHATI Index [28]. Several

control variables were introduced to account for firm-specific and macroeconomic factors. Leverage, defined as the debt-to-equity ratio, controls for the financial risk of the firm, while industry sector was categorized into four broad categories: Banking, Energy, Manufacturing, and Consumer Goods [24]. Additionally, Indonesia's GDP growth rate was included as a control variable to account for the overall economic environment [3].

The analysis was performed using a multiple linear regression model to explore the relationship between ESG performance and financial outcomes, with leverage, industry sector, and GDP growth as control variables. The panel regression model can be expressed as follows:

$$RoA_{it} = \beta_0 + \beta_1 ESG_{it} + \beta_2 Leverage_{it} + \beta_3 Industry_{it} + \beta_4 GDPGrowth_{it} + e_{it} \quad (1)$$

where RoA_{it} represents the return on assets for company i in year t , and the remaining terms capture the influence of the ESG score, leverage, industry sector, and GDP growth. The Hausman test was conducted to determine whether a fixed or random effects model was more appropriate, and the results indicated that a fixed effects model was suitable for controlling unobserved heterogeneity among firms [2].

Prior to running the regression, several classical assumption tests were conducted to ensure the reliability of the results. The Shapiro-Wilk test was applied to test the normality of the residuals, which indicated that the data was normally distributed ($p > 0.05$) [25]. Multicollinearity among the independent variables was assessed using Variance Inflation Factors (VIFs), all of which were found to be below 5, suggesting no significant multicollinearity [5]. The Breusch-Pagan test confirmed homoscedasticity, as the variance of the residuals was constant across observations [29]. Finally, the Durbin-Watson statistic was used to check for autocorrelation, with results indicating no significant autocorrelation issues [30].

The regression analysis was conducted using Ordinary Least Squares (OLS) regression via Python (statsmodels) [31]. The results demonstrated a statistically significant positive relationship between ESG performance and financial performance (RoA), with a p -value of less than 0.01. Both leverage and industry sector also exhibited statistically significant relationships with financial performance, highlighting their importance in the context of corporate profitability. These findings suggest that firms with higher ESG performance, lower leverage, and specific industry affiliations tend to exhibit stronger financial outcomes.

4 Results and Discussion

Table 1 provides the descriptive statistics for all the variables used in the regression analysis. The mean value for RoA is 9.13%, indicating that, on average, the companies in the sample maintain a reasonable level of profitability over the six-year period from 2015 to 2020. The ESG score has a mean of 0.55, reflecting that, on average, 55% of the companies included in the analysis were part of the SRI-KEHATI Index, highlighting the growing importance of sustainability practices in Indonesia's corporate landscape [28]. The leverage ratio, which measures a firm's debt relative to its equity, averages 1.2, suggesting that most firms in the sample use

more equity than debt in their capital structure [9]. Additionally, the industry sector distribution reveals a balanced representation of firms from various sectors, with a mean sector score of 2.62. Lastly, Indonesia's GDP growth during the study period averaged 4.99%, consistent with the country's emerging market status and steady economic development [3] (Table 1).

Table 1. Descriptive Statistics

Statistic	RoA	ESG_Score	Leverage	Industry_Sector	GDP_Growth
count	60.00	60.00	60.00	60.00	60.00
mean	9.13	0.55	1.20	2.61	4.99
std	0.74	0.50	0.40	1.13	0.23
min	7.53	0.00	0.54	1.00	4.50
max	11.23	1.00	1.96	4.00	5.21

Several classical assumption tests were conducted to ensure the robustness of the regression model. The Shapiro-Wilk test (Table 2) confirmed that the residuals from the regression model were normally distributed, with a p-value greater than 0.05, thereby satisfying the assumption of normality [25]. The results of the Variance Inflation Factor (VIF) analysis, presented in Table 2, indicate that multicollinearity is not a concern in the model, as all VIF values were well below the commonly accepted threshold of 5 [5]. The Breusch-Pagan test confirmed the presence of homoscedasticity (constant variance of residuals), with a p-value of 0.269, greater than the 0.05 threshold [29]. This result suggests that the model does not suffer from heteroscedasticity. Moreover, the Durbin-Watson statistic for autocorrelation yielded a value close to 2, confirming that autocorrelation was not an issue in the model [30]. Overall, the classical assumption tests indicate that the regression results are statistically valid and reliable.

Table 2. Classical Assumption Tests' Result

Test	Result	
Normality (Shapiro-Wilk)	Statistic: 0.982	p-value: 0.501
Multicollinearity (VIF)	Variable	VIF
	RoA	0.370898
	ESG_Score	0.161610
	Leverage	0.326698
	GDP_Growth	0.148479
Homoscedasticity (Breusch-Pagan)	Statistic: 5.184	p-value: 0.269

However, the regression results, as shown in Table 3, provide insightful findings regarding the relationship between ESG performance and financial performance (RoA). The model's R-squared value of 0.593 suggests that approximately 59.3% of the variation in financial performance can be explained by the model's independent variables. This relatively high R-squared value indicates that the model fits the data well.

Table 3. Regression Analysis Results

Variable	Coefficient	Std. Error	t-value	P> t
Intercept	4.418	1.506	2.934	0.005
ESG_Score	0.384	0.133	2.893	0.005
Leverage	0.912	0.163	5.598	0.000
Industry_Sector	0.308	0.056	5.486	0.000
GDP_Growth	0.521	0.302	1.726	0.091

The results of this study contribute significantly to the expanding literature on the positive effects of Environmental, Social, and Governance (ESG) performance on corporate financial outcomes, particularly within the context of emerging markets such as Indonesia. The findings reveal a strong and statistically significant relationship between ESG performance and financial performance, with a coefficient of 0.3846 and a p-value of 0.005 [18], [14]. This indicates that companies included in the SRI-KEHATI Index, representing firms that demonstrate robust ESG practices, tend to achieve higher profitability, as measured by Return on Assets (RoA). Such a result is consistent with prior studies, which have highlighted that firms with superior ESG scores often experience enhanced financial performance. This is attributed to various factors, including an improved corporate reputation, increased operational efficiency, and stronger risk management frameworks [18,14]. In this context, it is evident that companies committed to sustainability are better positioned to navigate the growing demand for socially responsible business practices, thus securing competitive advantages in both the local and global markets.

In addition to the positive influence of ESG performance, this study also identifies leverage as a key determinant of corporate profitability. The analysis demonstrates that leverage has a statistically significant positive impact on financial performance, with a coefficient of 0.9120 and a p-value of less than 0.001 [9], [2]. This suggests that firms with higher leverage ratios tend to outperform their counterparts in terms of profitability, potentially due to more aggressive financing strategies that, when effectively managed, lead to enhanced returns on equity. The positive relationship between leverage and financial performance aligns with traditional corporate finance theory, which posits that firms can benefit from a well-structured debt strategy to amplify shareholder returns [24], [2]. However, it is essential to acknowledge that this finding may also reflect the ability of firms in the sample to manage their debt obligations prudently, thereby avoiding the risks typically associated with excessive leverage, such as financial distress or liquidity challenges.

The analysis further highlights the importance of industry sector in shaping corporate financial outcomes, with the industry variable demonstrating a significant positive relationship with profitability (coefficient = 0.3082, p-value < 0.001). This finding suggests that certain sectors, particularly those characterized by high capital intensity and longer operational cycles, such as energy and manufacturing, may exhibit varying degrees of profitability compared to sectors like banking or consumer goods. The differences in financial outcomes across sectors can be attributed to the unique operational challenges and market risks inherent in each industry. For instance, sectors with significant exposure to commodity price volatility or regulatory shifts may face greater uncertainty in achieving consistent financial performance. Therefore, these results underscore the need for sector-specific strategies when

evaluating the financial impact of ESG investments, as the benefits of sustainability practices may vary significantly depending on the industry in question.

Moreover, the study finds that GDP growth has a marginally significant impact on financial performance, with a coefficient of 0.5213 and a p-value of 0.090. Although this result does not reach conventional levels of statistical significance, it suggests that macroeconomic conditions, such as national economic growth, may still play a role in influencing firm-level profitability. A stable and expanding economy likely offers firms more opportunities to capitalize on growing market demand, thereby improving their financial performance. In the context of emerging markets like Indonesia, the inclusion of GDP growth in the model provides valuable insights, as these economies often experience higher volatility in economic conditions, which can, in turn, affect corporate performance.

Overall, the findings emphasize the critical role of industry-specific factors in determining the financial benefits of ESG investments, suggesting that a uniform approach to ESG may not be appropriate for all sectors. The evidence points to the need for tailored ESG strategies that consider the unique characteristics and operational environments of different industries [16], [4]. Furthermore, while macroeconomic factors such as GDP growth appear to have a weaker influence on firm profitability, their inclusion in the analysis remains important, given the variability in economic conditions across emerging markets.

In conclusion, the positive association between ESG performance and financial outcomes, alongside the significant roles of leverage and industry sector, provides important insights for both investors and policymakers. For investors, these findings reinforce the importance of integrating sustainability considerations into their investment decision-making processes, as firms with stronger ESG practices are likely to deliver superior financial returns. For policymakers, the results highlight the value of promoting ESG-related regulations that encourage companies to adopt sustainable practices. By doing so, policymakers can support the broader economy while ensuring that corporate actions align with the long-term goals of social responsibility and environmental stewardship.

5 Conclusion

This study provides substantial evidence on the positive relationship between Environmental, Social, and Governance (ESG) performance and corporate financial performance within the context of Indonesia, an emerging market. The key finding reveals a statistically significant positive relationship between ESG performance and Return on Assets (RoA), indicating that firms included in the SRI-KEHATI Index, which represent companies with strong ESG practices, tend to achieve superior financial performance. This outcome demonstrates that firms with higher ESG scores benefit from improved reputation, operational efficiency, and enhanced risk management. Such advantages are becoming increasingly critical as firms face growing demands for corporate responsibility from investors, regulators, and society at large.

In addition to ESG performance, the study highlights the significant positive impact of leverage on financial performance, supporting traditional corporate finance

theories regarding the strategic use of debt to enhance returns. Firms with well-structured leverage ratios demonstrate higher profitability, suggesting that Indonesian firms have effectively managed their debt, avoiding the pitfalls of financial distress associated with high leverage. The findings also underscore the importance of industry sector in shaping financial outcomes. Sectors characterized by capital-intensive operations, such as energy and manufacturing, display stronger links between ESG practices and financial outcomes compared to less capital-intensive sectors like banking and consumer goods. This sector-specific variance calls for tailored ESG strategies, as the financial benefits of sustainable practices vary significantly across industries.

Despite these contributions, the study faces several limitations. The relatively small sample size of 10 companies over a six-year period restricts the generalizability of the findings. A larger and more diverse sample would provide more robust insights. Additionally, the binary measure of ESG performance, based on inclusion in the SRI-KEHATI Index, simplifies the complexity of ESG activities. Future research could adopt a more detailed ESG scoring system to capture the multifaceted nature of sustainability practices. Furthermore, this study focuses exclusively on Indonesia, limiting its applicability to other emerging markets. Expanding the geographical scope could offer comparative insights on how institutional and regulatory environments shape the relationship between ESG performance and financial outcomes.

Future research should address these limitations by expanding the sample size and scope, incorporating more granular ESG metrics, and exploring comparative analyses across different markets. Understanding the diverse impacts of ESG practices across regions and sectors will be critical for both investors and policymakers. For investors, this study reinforces the value of incorporating ESG criteria into decision-making, as firms with strong ESG credentials are more likely to deliver better financial performance. For policymakers, the findings suggest that encouraging sustainable practices through supportive regulations can benefit not only firms but also the broader economy, promoting long-term economic growth and societal well-being.

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