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Determinant of Financial Performance in Indonesia Firm

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ABSTRACT

Global climate change and the transition toward green energy have created significant challenges for Indonesia's manufacturing industry. This study aims to explain the causal relationship between the independent variables ESG and Risk Management Disclosure and the dependent variable, financial performance, with green innovation serving as a moderating variable. The research is grounded in stakeholder theory and contingency theory and employs a quantitative research design.The population of this study consists of all manufacturing companies listed on the Indonesia Stock Exchange (IDX). The sample includes manufacturing firms that meet the research criteria; from a total of 232 companies, 24 firms were selected, resulting in 120 observational units over a five-year period.The findings confirm that ESG, Risk Management Disclosure, and green innovation significantly improve financial performance.These results provide new insights into the integration of green innovation as a moderating factor within the manufacturing sector.

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Introduction

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Global climate change and the transition to green energy have presented significant challenges for Indonesia's manufacturing industry [1]. As a developing country that relies heavily on natural resources, Indonesia is vulnerable to extreme climate impacts, such as frequent floods and droughts, which exacerbate our dependence on fossil fuels, ultimately driving up energy costs by 15-20 percent [2]. Despite this, Indonesia's contribution to global greenhouse gas emissions remains substantial; the country ranks sixth, with emissions reaching 704.4 million tons of CO_2, just below Japan but above Iran and Saudi Arabia[3], [4]. The transition to green energy requires a massive investment in green technologies, but access remains limited, especially for small and medium-sized businesses [5]. The manufacturing sector itself deserves special attention because it contributes more than 19% to the national Gross Domestic Product (GDP) and is a major source of carbon emissions and industrial waste [6]. This situation emphasizes the importance of implementing better sustainability governance so that companies can maintain competitiveness while preserving their financial performance [7].

Financial performance is a company's ability to generate profits [2]. When this performance is considered solid, it shows that the company is able to maintain its liquidity and solvency, enabling it to withstand various risks, both short-term and long-term [8]. On the other hand, in the decision-making process, financial performance is often the primary benchmark for investors, creditors, and other stakeholders to evaluate the company's future growth potential[9]. Further, stable financial performance usually implies that a company can run its operations consistently and adapt to market changes [10], [11]. Financial performance is influenced by ESG (Environmental, Social, Governance) and Risk Management Disclosure

Stakeholder theory emphasizes that a company's survival is largely determined by its ability to meet the expectations and needs of various stakeholders, including investors, consumers, and the government [12]. ESG is a framework for achieving company performance through three main environmental, social, and governance. This framework helps measure how companies are fulfilling their responsibilities to the ecosystem, the well-

being of the community, and ethical and transparent management practices [13]. Research [14] states that ESG disclosure has a positive and significant relationship to financial performance. This suggests that the implementation of ESG by companies can improve financial performance [15], [16], [17] However, [18] found that ESG disclosures had no significant influence on financial performance. This suggests that ESG disclosures made by companies cannot improve financial performance [8], [19], [20]. Thus, a number of other studies have revealed conflicting results. As research conducted [21], [22], [23]. showed, ESG disclosure in Indonesia is often only symbolic or to comply with regulations, so it has no real impact on financial performance.

Risk Management Disclosure is the process of identifying, disseminating, and controlling threats to an organization's assets and revenue [24]. Findings from [25] found that Risk Management Disclosure has a positive and significant effect on financial performance because it can improve operational efficiency and internal control. This suggests that the risk management disclosure that the company undertakes can improve financial performance [25],[26]. If risk management disclosure does not have a significant influence on financial performance, this shows that risk management disclosure, what the company does, cannot improve financial performance [25], [28], [29] A number of other studies have shown different results. As the research conducted [8], reveals, companies with strong risk management disclosure tend to have better financial stability and the ability to generate higher profits [30].

The inconsistency of these empirical findings indicates that the impact of risk management disclosure on financial performance is not universal, but may depend on certain organizational contexts and strategic capabilities[31]. This research addresses this gap by introducing Green Innovation as a moderating variable, which constitutes the main novelty of the study[32]. Unlike prior studies that predominantly examine risk management disclosure as a standalone predictor, this study extends the literature by positioning green innovation as a strategic contingency that shapes the effectiveness of risk management disclosure in improving financial performance [33]. [34] Grounded in contingency theory, this study argues that the effectiveness of ESG disclosure and risk management disclosure

in enhancing financial performance is highly dependent on a firm's strategic orientation toward green innovation [35], [36]. Green innovation refers to a firm's efforts to develop environmentally friendly products, processes, or technologies aimed at reducing environmental impact while improving internal resource efficiency [3], [37] Prior studies have shown that green innovation positively and significantly affects financial performance by reducing reputation-building costs and strengthening competitive advantage, ultimately enhancing profitability [21], [35], [38]. However, other studies indicate that green innovation involves substantial investment costs, which may negatively affect short-term financial performance [39],[40]. This suggests that green innovation does not consistently improve financial performance across all firms and contexts [21]. Building on these contrasting findings, this study offers a novel contribution by conceptualizing green innovation not as a direct determinant, but as a moderating mechanism that conditions the relationship between risk management disclosure and financial performance [35]. By integrating risk management disclosure and green innovation within a contingency-based framework, this study provides a more nuanced explanation for the mixed empirical evidence and contributes to the ESG and risk management literature by highlighting the strategic role of green innovation in transforming risk disclosure into tangible financial outcomes [39], [40].

The selection of manufacturing companies as the object of research is based on the fact that this sector has a greater environmental impact than other sectors, so ESG practices and Green Innovation Become very important [41], [42]. The manufacturing industry produces carbon and waste emissions on a large scale, thus exposing risk management disclosure, environment, and green innovation as crucial factors in influencing financial performance [43], [44].

Stakeholder Theory

This study is primarily grounded in Stakeholder Theory, which serves as the grand theory. Stakeholder theory posits that a firm's sustainability and performance are determined by its ability to fulfill the expectations of various stakeholders, including investors, customers, regulators, and society at large [45]. In this context, the implementation of ESG

practices represents a strategic response to stakeholder demands for transparency, accountability, and environmental and social responsibility [12]. By addressing these expectations, firms can enhance legitimacy, reduce stakeholder-related risks, and strengthen long-term financial performance [46]. Consistent with this theoretical perspective, ESG disclosure and risk management disclosure are conceptualized in this study as mechanisms through which firms communicate their commitment to responsible and sustainable business practices to stakeholders [47]. Accordingly, Stakeholder Theory provides the fundamental rationale for hypothesizing a direct relationship between ESG, risk management disclosure, and financial performance [48].

Contingency Theory

Contingency theory argues that the effectiveness of managerial strategies depends on the specific organizational and environmental context faced by the firm [50]. In this study, contingency theory is used to explain that the impact of ESG and risk management disclosure on financial performance is conditional, depending on the firm's strategic orientation toward green innovation [32]. Firms that successfully integrate sustainability initiatives with innovation capabilities are better positioned to respond to market dynamics, regulatory pressures, and technological change, leading to superior performance outcomes [51]. Thus, contingency theory provides the theoretical basis for positioning green innovation as a moderating variable, suggesting that the relationship between ESG and risk management disclosure and financial performance is not uniform but varies according to the firm's adaptive capacity and innovation strategy [52].

Financial Performance

Financial performance is the company's ability to generate profits, often measured through financial statements and ratio analysis as a performance indicator [54]. Strong financial performance reflects financial health, demonstrating a company's capacity to maintain liquidity and solvency, enabling it to meet both short-term and long-term challenges [55]. On the other hand, in the decision-making process, financial performance is often the primary benchmark for investors, creditors, and other stakeholders to evaluate the company's

future growth potential [9]. Overall, good financial stability reflects sustainable operational capabilities and adaptation to market changes [56].

Environmental, Social, Governance

ESG is a framework for achieving company performance through three main environmental, social, and governance. This framework helps measure how companies are fulfilling their responsibilities to the ecosystem, the well-being of the community, and ethical and transparent management practices [13]. Environmental aspects, for example, assess the management of ecological impacts such as carbon emissions, energy consumption, and waste management [57], [58], [59], [60], [61], [62]. Meanwhile, the social dimension emphasizes the company's contribution to the well-being of employees, society, and other stakeholders through fair labor policies, harmonious industrial relations, and social empowerment programs[63].

Risk Management Disclosure

Risk Management Disclosure is the process of identifying, disseminating, and controlling threats to an organization's assets and revenue [24]. Once the risks have been identified, the next step is an assessment to measure the probability of the event and the scale of its impact on capital, revenue, and operational stability [64], [65]. Once the risk is identified, the company conducts an assessment process to measure the likelihood of occurrence and the magnitude of the impact it may have on capital, revenue, and operational stability [66]. This evaluation is crucial to determine the level of risk and the priority of its handling, so that companies can design the right mitigation strategy [67].

Green Innovation

Green innovation is the company's effort to develop environmentally friendly products, processes, or technologies to reduce negative impacts on the environment while improving the efficiency of internal resource use [33]. This concept is crucial in driving sustainable transformation, as it integrates ecological values into business activities, ultimately creating a long-term competitive advantage [68], [69], [70]. Companies with

green innovation typically demonstrate superior operational performance and reputation, as they are able to comply with environmental regulations while building stakeholder trust [71].

ESG and Financial Performance

ESG is a framework for achieving company performance through three main environmental, social, and governance. This framework helps measure how companies are fulfilling their responsibilities to the ecosystem, the well-being of the community, and ethical and transparent management practices [13]. Stakeholders emphasize that a company is largely determined by its ability to meet the expectations and needs of various stakeholders, including investors, consumers, and the government [12], [46]. Research [14] states that ESG disclosure has a positive and significant relationship to financial performance. This suggests that the implementation of ESG by companies can improve financial performance [15], [16], [17]. The hypotheses proposed in this study are:

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

Risk Management Disclosure and Financial Performance

Risk Management Disclosure is the process of identifying, disseminating, and controlling threats to an organization's assets and revenue [24]. Stakeholders emphasize that a company is largely determined by its ability to meet the expectations and needs of various stakeholders, including investors, consumers, and the government [12], [46]. Findings from [25] found that Risk Management Disclosure has a positive and significant effect on financial performance because it can improve operational efficiency and internal control. This suggests that the risk management disclosure that the company undertakes can improve financial performance [26], [27]. The hypotheses proposed in this study are:

H2: Risk management Disclosure has a positive effect on the company's Financial Performance

ESG and Risk management Disclosure with Green Innovation Moderation Financial Performance

Green innovation is the company's effort to develop environmentally friendly products, processes, or technologies to reduce negative impacts on the environment while improving the efficiency of internal resource use [33]. Contingency theory explains that the

effectiveness of managerial strategies is greatly influenced by the situational context that the company is facing [32]. Research [34] reveals that green innovation has a positive and significant effect on financial performance because it can reduce reputation-building costs and strengthen competitiveness, which ultimately has a positive impact on profitability. This suggests that the green innovations the company undertakes can improve financial performance [35], [36]. The hypotheses proposed in this study are:

H3: green innovation moderates ESG on a company's financial performance

H4: green innovation moderates Risk management Disclosure on the company's financial performance

Conceptual Framework

This conceptual framework is built to clarify the relationship and impact that occurs between independent variables (X) and dependent variables (Y). In addition, this framework also shows how the moderation variable (Z) plays a role in strengthening or even weakening the relationship between independent variables (X) and dependent variables (Y) [72]. The complete picture of the conceptual framework of this research can be seen in the image below:

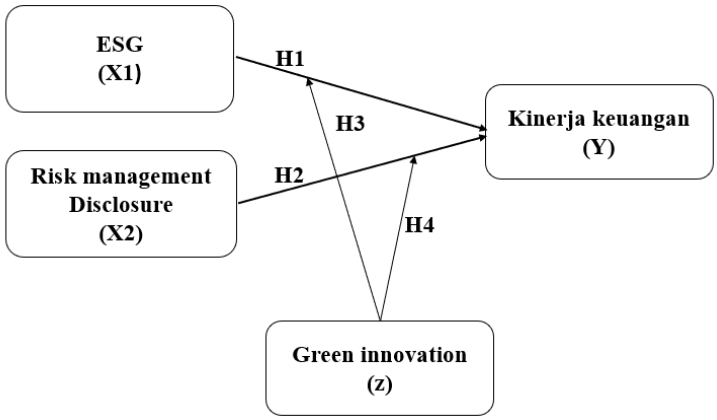

Figure 1. Conceptual Framework

Source: Processed Data (2025)

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Method

This study uses a quantitative approach to systematically analyze the data. The population is all companies listed on the Indonesia Stock Exchange (IDX) during the research period. There are 232 manufacturing companies, and through purposive sampling techniques, 24 companies were selected as samples. The secondary data source comes from the company's financial statements listed on the IDX, obtained through the IDX official website (www.idx.co.id) or the website of each company, with a time range from 2020 to 2024. For data analysis techniques, this study uses STATA 17. By applying the panel data model estimation. There are three panel data regression methods that can be used, namely the Common Effect Model (CEM), the Fixed Effect Model (FEM), and the Random Effect Model (REM). The selection of the most suitable method is carried out through several statistical tests. First, the F test is used to determine whether to use the Common Effect Model (CEM) or the Fixed Effect Model (FEM). Second, the Lagrange Multiplier (LM) test helps choose between the Common Effect Model (CEM) and the Random Effect Model (REM). Third, the Hausman test is applied to decide between a Fixed Effect Model (FEM) and a Random Effect Model (REM). Thus, this approach ensures that the chosen model corresponds to the characteristics of the existing data.

Table 1. Definition and measurement of Variables

No	Variable	Variable Types	Measurement Indicators	Data Source	Source
1	ESG Score	Independent (X_1)	ESG = $\frac{jumlah\ score\ implementasi}{Total\ item}$	Sustainability Report	[73]
2	*Risk management Disclosure*	Independent (X_2)	RMD = $\frac{jumlah\ score\ implementasi}{Total\ item}$	Annual Report	[74]

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3	Financial Performance	Dependent (Y)	ROA = $\frac{laba\ bersih}{total\ aset}$	Annual Financial Report	[4]
4	*Green Innovation*	Moderation (Z)	PROPER: 5 (Gold), 4 (Green), 3 (Blue), 2 (Red), 1 (Black)	PROPER KLHK	[3]

Source: Data processed (2025)

Results and Discussion

Descriptive Statistical Results

Table 2. Descriptive statistical results

Variable	N	Mean	Standard Deviation	Minimum	maximum
Environmental, Social, Governance (ESG)	120	1	0.04	1	1
Risk management Disclosure	120	4	0.04	3	5
Green innovation	120	4	0.70	3	5
Financial performance	120	0.03	0.15	-0.94	0.34

Source: Data processed (2025)

Table 2 shows that ESG has a minimum value of 1 and a maximum value of 1, with an average of 1 and a low standard deviation of 0.04, indicating consistently high ESG disclosure among the sample companies. The risk management disclosure shows a minimum value of 3 and a maximum value of 5, with an average of 4 and a standard deviation of 0.04, indicating generally effective risk management implementation. Green innovation exhibits sufficient variation, with a minimum value of 1, a maximum value of 5, an average of 4, and a standard deviation of 0.70, which influences the relationships between variables. Financial

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performance has a minimum value of -0.94, a maximum of 0.34, and a standard deviation of 0.15, with an average of 0.03. This reflects that the existing companies are quite efficient in utilizing their assets and generating profits. Overall, the research data has sufficient variation to perform regression analysis to test the relationships between variables.

Panel data model selection

The following is the selection of the most suitable model between the Random Effect Model (REM), Common Effect Model (CEM) and Fixed Effect Model (FEM) through three tests as follows:

Table 3. Results of Panel Data Model Selection Tests

Test Method	Test Statistic	Probability	Decision Rule (A=5%)	Selected Model
Chow Test	Prob. F	0.0554	> 0.05→ Accept H_0	Common Effect Model (CEM)
Hausman Test	Prob > X^2	0.2492	> 0.05 →Accept H_0	Random Effect Model (REM)
Lagrange Multiplier (LM)	Prob > X^2	0.2712	> 0.05→ Accept H_0	Common Effect Model (CEM)

Source: Data processed (2025)

Table 3 summarizes the panel data model selection results. The Chow test yields a probability value of 0.0554 (> 0.05), indicating that the Common Effect Model (CEM) is preferred over the Fixed Effect Model (FEM). The Hausman test shows a probability value of 0.2492 (> 0.05), suggesting that the Random Effect Model (REM) is preferable to FEM. However, the Lagrange Multiplier test produces a probability value of 0.2712 (> 0.05), indicating that REM is not statistically superior to CEM. Based on the overall test results, the Common Effect Model (CEM) is selected as the most appropriate panel data regression model for this study.

Panel Common Effect Model

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Table 4. Data panel common effect model

Variable	Coefficient	Std. Error	z-Stat	p-Value
ESG	0.181	0.106	1.72	0.086*
Risk management Disclosure	0.160	0.087	1.84	0.066*
Green innovation	0.604	0.031	19.76	0.000***
Constant	–1.248	0.356	–3.50	0.000***

Description: p < 0.01; **p < 0.05; *p < 0.10

Source: Data processed (2025)

Table 4 shows that the common Random-Effects regression model yields a Prob > chi^2 = 0.0000, indicating that the variables ESG, Risk management Disclosure, and green innovation are simultaneously significant in explaining variations in financial performance. An Overall R^2 value of 0.9964 indicates that the model is very capable of explaining data variability, although this very high number usually reflects panel data with a very strong structure or stable relationships between variables. The rho value = 0.1522 indicates that about 15.22% of the variance comes from the effect of differences between individuals. This means that the random effects model is feasible because there is variation between groups but not too large, and the assumption corr(ui, X) = 0 is still acceptable.

General Least Square Method

Table 5. Simultaneous test results

F Wald chi2(27) = 53.75
Prob > chi2 = 0.0016
Predictors: Esg, Risk management Disclosure,green innovation
Dependent variables: financial performance

Source: Data processed (2025)

Table 5 shows that this study uses the Feasible Generalized Least Squares (FGLS) estimation method to overcome the problem of heteroscedasticity and autocorrelation. The results of simultaneous testing using the Wald Test show a value of

chi2(27) of 53.75 with a probability value of Prob chi2 of (0.0016). Since this probability value is much smaller than the significance level of alpha = 0.05, the null hypothesis is accepted. This concludes that together, all independent variables in the model have a significant effect on the dependent variables of financial performance.

Data Normality Test

Table 6. Results of the normality test of sahpiro-wilk data

Variable	Number of Observations (N)	Statistical value (W)	Probability (p)	Conclusion
Residual data	120	0.99398	0.88966	Normal

Source: Data processed (2025)

Table 6 shows that the test results of the probability value = 0.88966 are greater than 0.05, then the Normality Assumption of the data is met.

Multiple Linear Regression Analysis Model

Table 7. Regression results robust standard error

Variable	COEF	Std. Err	t-value	p-value	[95% conef	Conclusion
ESG	0.209	0.209	2.24	0.027**	0.239	H1 : Accepted
Risk management Disclosure.	0.138	0.073	1.88	0.064*	-0.007	H2: Accepted
Green innovation	0.598	0.039	15.31	0.000***	0.520	H3: Accepted H4: Accepted
constant	-1.343	0.309	-4.34	0.000	-1.956	Conclusion

Note:*** Significant at alpha=1%. ** Significant at alpha=5%. * Significant at alpha=10%.

Source: Data processed (2025)

Table 7 shows that ESG has a positive and significant effect at a rate of 5% (β = 0.209; p = 0.027), which indicates that the higher the company's sustainability practices, the

better its financial performance. Risk management disclosure also shows a positive direction with significance at the level of 10% (β = 0.138; p = 0.064), which means that strengthening the risk management system still has the potential to improve performance, although the effect is not as strong as other variables. Meanwhile, Green Innovation was the most dominant variable with a positive and very significant influence at the level of 1% (β = 0.598; p = 0.000), indicating that environmentally friendly innovation is a strategic factor that consistently encourages improvement in financial performance. The value of a negative constant reflects that without these three variables, financial performance tends to be at a low level.

Discussion

Environmental, Social, Governance (ESG) on the company's financial performance

The results of the study show that it has a positive and significant effect on financial performance with an ESG coefficient of 0.209 with a p-value of 0.027, which is significant at the level of 5%. This means that any unit increase in the ESG score tends to increase the company's ROA by about 0.209 units, assuming other variables are constant Stakeholders emphasize that a company is largely determined by its ability to meet the expectations and needs of various stakeholders, including investors, consumers, and the government [12], [46]. Research [14] states that ESG disclosure has a positive and significant relationship to financial performance. This suggests that the implementation of ESG by companies can improve financial performance [15], [16], [17].

The Effect of Risk Management Disclosure on Financial Performance

The results indicate that risk management disclosure has a positive and marginally significant effect on financial performance, with a coefficient of 0.138 and a p-value of 0.064, which is significant at the 10% level. This suggests that improvements in risk disclosure, as measured by the risk disclosure index, are associated with an increase in ROA by 0.138 units. Accordingly, H2 is supported [75]. Although the statistical significance is

observed at the 10% level, this finding remains meaningful for several reasons [12]. First, prior empirical studies in the fields of corporate governance and risk disclosure frequently accept a 10% significance level, particularly in panel data settings where firm-level heterogeneity and disclosure practices may weaken statistical power [46]. Second, the positive coefficient is consistent in direction and magnitude with theoretical expectations derived from stakeholder and agency perspectives, indicating that transparent risk disclosure enhances stakeholder confidence and reduces information asymmetry, which ultimately contributes to financial performance.[76].Third, the result is robust across alternative estimations, as evidenced by the FGLS and robust standard error models, which consistently produce a positive effect for risk management disclosure [25]. Therefore, despite being marginally significant, the result provides sufficient empirical support to accept H2, while acknowledging that the effect should be interpreted with caution and may benefit from further validation in future studies with broader samples or longer observation periods [26],[27].

ESG and Risk management Disclosure with Financial Performance in Green Innovation Moderating

The results of the study show that Green innovation shows the highest coefficient of 0.598 with a p-value of 0.000, very significant. As a moderation variable, green innovation strengthens the relationship between ESG and risk management and financial performance. These findings support the H3 and H3 accepted hypotheses. Contingency theory explains that the effectiveness of managerial strategies is greatly influenced by the situational context that the company is facing [32]. Research [34] reveals that green innovation has a positive and significant effect on financial performance because it can reduce reputation-building costs and strengthen competitiveness, which ultimately has a positive impact on profitability. This suggests that the green innovations the company undertakes can improve financial performance [52], [55].

Conclusion

The findings of this study indicate that ESG disclosure and risk management disclosure positively influence financial performance, while green innovation strengthens this relationship in manufacturing companies in Indonesia. The inclusion of green innovation as a moderating variable represents the main novelty of this study, providing a new perspective that sustainability-related disclosures generate superior financial outcomes when supported by firms' innovation capabilities. Theoretically, these results extend stakeholder and contingency theories by confirming that the impact of ESG and risk management disclosure on financial performance is conditional rather than uniform, helping to explain the mixed empirical findings reported in prior studies.From a practical and policy perspective, the results suggest that ESG and risk management disclosure should be viewed not merely as compliance mechanisms but as strategic tools that create financial value when integrated with green innovation initiatives. Managers and investors are encouraged to consider firms' green innovation capability when evaluating the financial relevance of sustainability disclosures. For the Indonesian context, regulators may enhance the effectiveness of sustainability reporting by aligning disclosure requirements with incentives for green innovation, such as green financing schemes and sustainable investment programs, thereby improving corporate competitiveness and long-term financial resilience. Nevertheless, the limited sample size due to incomplete sustainability reporting warrants cautious interpretation, and future research is encouraged to incorporate additional variables such as carbon emission disclosure and financial slack, as well as broader industry and country coverage.

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