REGULATION AND CORPORATE ENVIRONMENT SOCIAL GOVERNANCE SCORE IN INDONESIA

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ABSTRACT

This paper aims to analyze regulations and Environment Social and Governance (ESG) scores in Indonesia. The ESG assessment in Indonesia was carried out by the Indonesian Stock Exchange in collaboration with Morningsatar Sustainalytics. Research was carried out using a qualitative approach with literature reviews and descriptive methods. A literature review was conducted to analyze ESG policies in Indonesia. Descriptive analysis is carried out to see the issuer's ESG score. Data on ESG scores and controversy scores were obtained from the list issued by the IDX via idx.co.id as of 31 December 2023. There are 79 companies on the list. Based on the results of the literature review, OJK has regulated the content of sustainability reporting that companies must carry out so that companies are obliged to comply comprehensively. The descriptive test results show that the average ESG risk value for 79 companies is 29.32. There are 32 or 40.51% of companies in the high and severe categories. This means that quite a lot of companies in Indonesia have high or even severe ESG risks. The high and severe ESG risk categories are dominated by energy sector companies.

Keywords: ESG, Regulation, Indonesian Stock Exchange (IDX), Risk Value

INTRODUCTION

Environment, Social and Governance (ESG) is a broad set of environmental, social and corporate governance considerations that have the potential to have an impact on a company's ability to implement business strategies and build value in the long term (Ningwati et al., 2022). The environment is the main focus of many parties. Companies and entrepreneurs are no longer expected to carry out their business operations well but also pay attention to how their business impacts the surrounding environment (Junius et al., 2020). Environmental, social and governance awareness is in line with the concept of sustainability. ESG is a standard and certain parameters that companies apply in carrying out their business sustainably.

ESG refers to a comprehensive approach to investor and company decision making through analysis of sustainability factors (Yawika & Handayani, 2019). This is expected to improve company performance and convince stakeholders that there is no negative impact from company activities. Based on legitimacy theory, companies must pay more attention to social and environmental issues to gain legitimacy so as to gain trust and support from society. In line with stakeholder theory, companies will strive to maintain their relationships with stakeholders by meeting needs for the company's long-term interests. (Li et al., 2021) reveal that ESG is the standard and strategy used by investors to evaluate a company's behavior and financial performance in the future.

ESG guidelines were first published in 2006 by the United Nations Principles of Responsible Investment (Trisnowati et al., 2022). This guideline is used as a basis for making decisions on environmental, social and corporate governance aspects. In 2008 the guidelines were adapted from those published by the Chartered Financial Analyst Institute. In Indonesia, investing with attention to ESG values began with the creation of the SRI Kehati index in 2009 (Adi Cakranegara, 2021). The Financial Services Authority (OJK) then issued special ESG regulations through OJK Regulation No, 51 of 2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers and Public Companies. The Ministry of Finance also published an ESG Framework and Manual on government support and facilities for infrastructure financing in 2021. The framework was prepared to provide a positive economic impact.

The topic of sustainability is progressively emerging as a significant focal point for both business leaders and society (Hendro & Bowo Pranogyo, 2023). The Indonesian Stock Exchange introduced several sustainability-related indices, such as IDX ESG Leaders, ESG Sector Leaders IDX Kehari, and ESG Quality 45 IDX Kehati. These indices were launched between 2020 and 2021. They gauge the price performance of stocks with favorable Environmental, Social, and Governance (ESG) ratings, devoid of significant controversies, and exhibiting strong financial performance.

ESG is often linked to company performance and value. A number of studies show that ESG can be an indicator of good performance of a company (Wahdan Arum Inawati & Rahmawati, 2023; Yawika & Handayani, 2019; Zhao et al., 2018). Several other research results also show that stakeholders react positively when companies engage in ESG practices (Amalia & Kusuma, 2023; Aydoğmuş et al., 2022; Hu et al., 2023; Zheng et al., 2022). This means that ESG scores are a concern for stakeholders in making business decisions.

This paper aims to analyze ESG regulations and implementation in Indonesia. The ESG assessment in Indonesia was carried out by the Indonesian Stock Exchange in collaboration with Morningsatar Sustainalytics. Analysis of regulations will be carried out through a review of existing regulations and circulars related to ESG for issuers until December 31, 2023. This research will also provide a descriptive analysis of the ESG scores of companies listed on the Indonesia Stock Exchange so that it can provide an overview of the implementation of the sustainability concept in Indonesia. Descriptive analysis carried out includes minimum score, maximum score, average ESG score and crosstab analysis for comparison of each company sector and ESG category.

LITERATURE REVIEW

The relationship between ESG and its pillars can be discussed from various theoretical perspectives. Stakeholder theory is appropriate to explain companies that strive to help protect the environment, increase social welfare and fulfill governance practices (Lee & Isa, 2020). The stakeholder perspective states that good company management will maximize value by incorporating stakeholder values, so that they will be more likely to be involved in ESG activities. The initial thought that ESG was an agency problem that would reduce wealth is no longer relevant. Stakeholder theory states that the better a company manages its relationships with all stakeholders, the more successful it will be (Freeman, 1994). Based on this theory, ESG activities can be synergized in company performance.

Another theory that explains the ESG concept is legitimacy theory. Legitimacy is a general assumption that a company's actions are appropriate within a socially constructed system of norms, values, beliefs and definitions (Şeker & Şengür, 2021). Legitimacy theory is an explanation in research on ESG and CSR. The company protects its legitimacy with voluntary disclosure of environmental, social and corporate governance. This disclosure made by the company is used to calculate the ESG value. To increase its legitimacy, companies need to implement practices that are able to influence public assessment (Eliwa et al., 2021).

ESG itself is a sustainable concept that means development, investment and business activities comply with environmental, social and governance criteria. Ningwati et al. (2022) explain that in general ESG is a broad set of social environmental and corporate governance issues that have the potential to have an impact on a company's ability to implement business strategies and build long-term value. ESG measurements describe environmental, social and governance issues that are considered to influence company behavior.

ESG consists of three pillars, specifically environmental, social, and governance (Kumar, 2023). Environmental considerations encompass aspects such as a company's energy consumption, waste management, pollution levels, conservation efforts, and treatment of flora and fauna. Incorporating environmental criteria into a company's risk management practices serves to mitigate potential risks associated with these factors. Adoption of renewable energy sources, efficient utilization of natural resources, and effective waste management are among the tangible outcomes resulting from a company's integration of environmental considerations. Meanwhile, social criteria evaluate a company's interactions with external stakeholders, including the community, society at large, suppliers, customers, media, and other relevant parties. Social criteria look at the company's relationship with external parties, namely the community, society, suppliers, buyers, media and other parties. Adapting the company's position to social issues will affect the company's image. Company programs that have a positive impact on the conditions and welfare of stakeholders will have an impact on company performance. Governance criteria focus on how a company manages its internal parts well and sustainably. This criterion covers company activities, both management and owner activities so that policies, standards, culture and compliance are things that are taken into account. Corporate financial governance that is transparent, legal and does not violate ethical rights is something that investors and potential investors consider when making business decisions. Fulfilling ESG criteria will not only strengthen a company's reputation but also contribute to increasing the potential for sustainable growth (Şeker & Şengür, 2021). In detail, the indicators for each criterion can be seen in Table 1.

Table 1: Indicators on the ESG pillar

Environtment	Social	Governance
Climate Change	Human Rights	Board Independence
Carbon Emission	Labour Standards	Board Diversity
Pollution	Poverty	Transparency
Resource Erosion	Equal Health Opportunities	Share Holder's Participation
Biodiversity	Equal Education Opportunities	Employee Wellness
Green Coverage	Social Security	Equal Opportunity

Source: (Kumar, 2023)

The company's ESG performance assessment is carried out by world rating agencies (Priandhana, 2022). Quoted from the idx.co.id page, the Indonesian stock exchange is collaborating with Morningstar Sustainalytics to carry out ESG assessments. Sustainalytics carries out ESG risk assessments using the risk decomposition concept where companies are faced with two dimensions of ESG issues, namely exposure and managementExposure to significant ESG risks poses a challenge for companies and shapes the assessment of ESG risks. Management reflects the genuine dedication and efforts of a company in addressing ESG concerns through its array of policies and initiatives. Additionally, based on the evaluation of ESG scores, publicly traded companies are categorized into one of five groups as outlined in Table 2. In addition, Sustainalytics also conducts controversy research by identifying companies involved in incidents that could have a negative impact on stakeholders, the environment, or the company itself. Through this research, listed companies are grouped into the category without evidence or one of the 5 categories in table 3.

Table 2: ESG risk score categories

Risk Score	Category	Description
0-10	Negligible	Considered to have negligible ESG risk
10-20	Low	Considered to have low ESG risk
20-30	Medium	Considered to have moderate ESG risk
30-40	High	Considered to have high ESG risk
>40	Severe	Considered to have severe ESG risks

Source: (Sustainalytics, 2023)

Table 3: Controversial Value Category

Category	Description
0	There is no evidence of relevant controversy
1	Low impact on the environment and society. Negligible risk to the company.
2	Moderate impact on the environment and society with minimal risk to the company, Low frequency of incidents. The company has a strong management system and/or measures in place to mitigate risks.
3	Significant impact on the environment and society with significant business risks. Evidence of structural problems in the company and/or the company has an inadequate management system.
4	High impact on the environment and society with high business risks. Structural/systemic problems, repeated incidents and the company has an inadequate management system.
5	Severe impact on the environment and society with serious business risks. Incredible egregious behavior, high frequency of incidents and the company has poor controversy management.

Source: (IDX, 2023)

METHODOLOGY

The study utilized a qualitative methodology involving a literature review and descriptive techniques. This approach involved reviewing and synthesizing prior research by selecting pertinent literature, conducting analysis, and interpreting previous findings. The process of literature review encompassed identifying relevant literature, analyzing it, and ultimately mapping the outcomes of the review (Sekaran & Bougie, 2016). A literature review was conducted to analyze ESG policies in Indonesia. Analysis of regulations will be carried out through a review of existing regulations and circulars related to ESG for issuers until December 31, 2023. Apart from that, this research also uses descriptive analysis to look at the ESG scores of companies listed on the Indonesia Stock Exchange. Descriptive analysis carried out includes minimum score, maximum score, average ESG score and crosstab analysis for comparison of each company sector and ESG category. The ESG score will be used to analyze the position of companies in Indonesia against the specified risk categories. The level of controversy of companies that have ESG scores will also be analyzed in this research. Data on ESG scores and controversy scores were obtained from the list issued by the IDX via idx.co.id as of 31 December 2023. There are 79 companies on the list. The discussion will focus on these 79 companies. It can provide an overview of the implementation of the sustainability concept in Indonesia

DISCUSSION

Regulations regarding ESG in Indonesia began with Law no. 40 of 2007 concerning the obligation to carry out social and environmental responsibility activities for companies carrying out business activities in the natural resources sector. Furthermore, financial services authority regulation number 51/POJK.03/2017 was issued regarding sustainability reports. These two rules are the main regulations in ESG implementation in Indonesia. In accordance with these regulations, Financial Services Institutions, Issuers and Public Companies are required to implement sustainable finance and prepare reports. Implementing sustainable finance begins with preparing a financial action plan, implementing the plan, and communicating it to shareholders. The Financial Services Authority has prepared a Roadmap for Sustainable Finance in Indonesia for 2015-2019 and 2021-2025. In the banking sector, OJK has also specifically issued Technical Guidelines for Banks regarding the implementation of financial services authority Regulation Number 51/POJK.03/2017. Furthermore, Financial Services Institutions, issuers and public companies are required to prepare and publish sustainability reports. Singhania & Saini (2022) in their analysis classified Indonesia as a country with an ESG framework at an early stage along with Russia, Thailand, Nigeria and Vietnam. The classification is based on low ESG coverage and framework.

A Sustainability Report is a public announcement detailing the economic, financial, social, and environmental performance of a Financial Services Institution, Issuer, or Public Company in their pursuit of sustainable business practices. The sustainability report is prepared separately from the annual report or as an inseparable part of the annual report. The obligation to submit reports is carried out annually to the Financial Services Authority in accordance with the deadline for submitting annual reports. In 2020, Harymawan et al. (2020) found that sustainability disclosure in Indonesia is generally low but there is a positive correlation between quantity and quality. This means that companies that implement the sustainability concept tend to express it so that they show the actions they are taking. This disclosure is the basis for measuring the ESG score.

Financial services authority regulation Number 51/POJK.03/2017 has provided an explanation of the minimum information that must be included in a sustainability report. Companies must explain the sustainability strategies implemented. In addition, companies are required to disclose their performance over the last 3 (three) years on sustainability aspects which include economic aspects, environmental aspects and social aspects. Companies are also required to disclose sustainability governance. Based on the results of a literature review of these regulations, the Financial Services Authority has regulated the content of sustainability reporting that must be carried out by companies so that companies are obliged to comply comprehensively. The sustainability report prepared by the company is the basis for assigning ESG scores by rating agencies. In addition, Financial Services Authority Circular No. 16/SEOJK.04/2021 provides further guidance regarding the form and content of annual reports for issuers, including containing technical guidelines for preparing sustainability reports. The trend of sustainability reporting in Indonesia is increasing from year to year (Gunawan et al., 2022). Companies in Indonesia disclose the most ESG aspects in these reports compared to other aspects.

ESG Risk Score Assessment in ESG Reporting can show how effectively the issuer is implementing the ESG program thereby providing an overview of the company's economic valuation (Ramadhan et al., 2024). Descriptive analysis was carried out on the ESG scores of companies listed on the Indonesia Stock Exchange. Search results show that of the 902 registered companies, the Indonesian Stock Exchange has only released 79 companies that have ESG score information as of December 31 2023. This means that only 8.76% of companies implement ESG provisions in Indonesia. The average ESG risk score of the 79 companies was 29.32. PT Erajaya Swasembada Tbk has the smallest ESG risk score, namely 12.67. This score is included in the category of having low ESG risk. PT Erajaya Swasembada Tbk is a company in the Non-Primary Consumer goods sector in the specialized retail industry. This means that none of the companies listed on IDX have the negligible category. Meanwhile, the highest ESG risk score was obtained by PT Adaro Minerals Indonesia Tbk, namely 53.1. This score is included in the category of having severe ESG risk. PT Adaro Minerals Indonesia Tbk is a coal industry energy sector company. The results of the description test can be seen in table 4.

Table 4: Descriptive Test Results

Variable	Mean	Median	Minimum	Maksimum	Standard Deviation
ESG Scores	29,32	28,25	12,67	53,1	9,64

Source: data processed, 2024

A more in-depth analysis was carried out on the category position of each company's ESG score. There are 16 companies with the category considered to have low ESG risk or 20.25%. Meanwhile, 31 or 39.24% of companies are in the medium category or are considered to have moderate ESG risk. Interestingly, there are 32 or 40.51% of companies in the high and severe categories. This means that quite a lot of companies in Indonesia have high or even severe ESG risks. The high and severe ESG risk categories are dominated by energy sector companies. Details can be seen in table 5.

Table 5: Number of Companies per ESG Score Category

Risk Score	Category	Number of Companies	Percentage (%)
0-10	Negligible	0	0
10-20	Low	16	20,25
20-30	Medium	31	39,24
30-40	High	19	24,05
>40	Severe	13	16,46
Jumlah		**79**	**100**

Source: data processed, 2024

Figure 1 shows an analysis of ESG scores by sector. There are 11 sectors with 79 companies that have ESG scores. Companies that have ESG scores are dominated by the New Goods, Energy and Finance sectors with 13 companies each. Meanwhile, the industrial sector and the transportation & logistics sector are only represented by 2 companies each that have ESG scores. The lowest average ESG risk score was owned by companies in the Non-Primary Consumer Goods sector, namely 17.14. Meanwhile, companies in the energy and industrial sectors have the highest risk scores, namely 36.41 and 36.68. Even though there are only 2 companies, the industrial sector has the highest ESG risk among other sectors. The two companies are PT Astra International Tbk with an ESG score of 33.36 and PT United Tractors Tbk with an ESG score of 40. The findings of Antunes et al. (2023) show that companies that have an ESG risk score tend to be less susceptible to financial difficulties regardless of the ranking value obtained. Even though some companies in Indonesia have high ESG risk scores, this does not always mean they will be associated with financial difficulties. At the very least, companies that have an ESG risk score are more financially efficient compared to companies that do not have an ESG risk score.

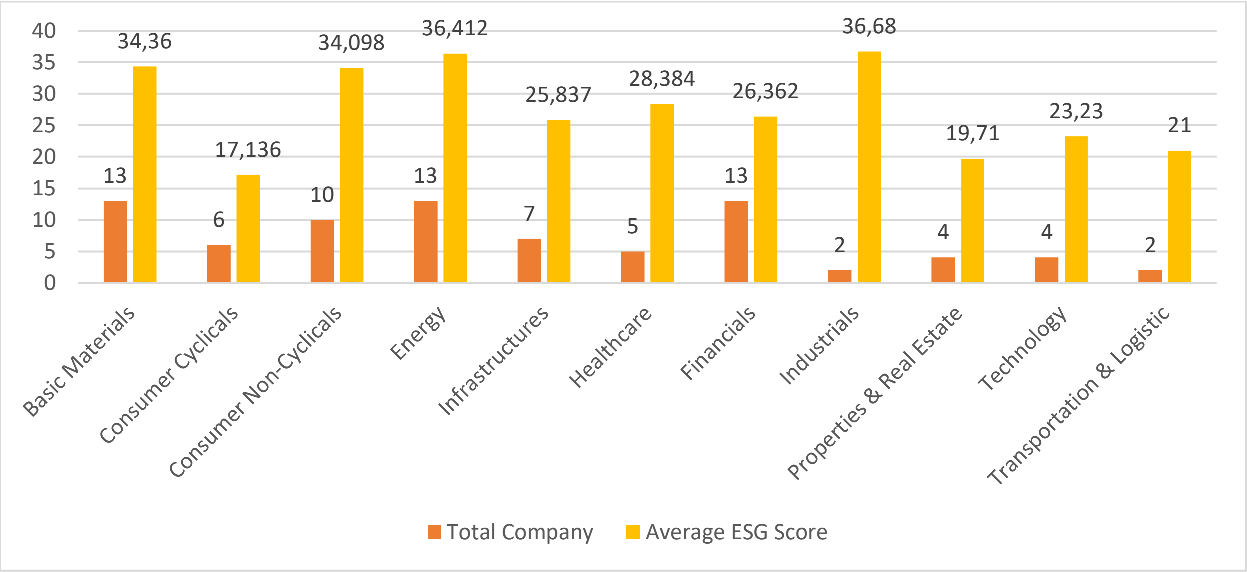

Figure 1: ESG Scores per Sector

Source: data processed, 2024

An investigation of the controversy value shows that 4 companies are in category 4, namely having controversies that have a high impact on the environment and society with high business risks. Structural/systemic problems, repeated incidents and the company has an inadequate management system. In category 1 there are 9 companies. There was only 1 company in category 3. Meanwhile, 53 or 67.09% of companies found no evidence of relevant controversy. The remaining 12 companies are in category 2 where the company has a moderate impact on the environment and society with minimal risk, low frequency of incidents but the company has a strong management system and/or actions taken to mitigate risk. Details can be seen in table 6. Nirino et al. (2021) suggest that there is a significant negative relationship between corporate controversy and financial performance. Controversy has a negative effect on company performance because it loses reputation and impacts company activities. Most companies have a low controversy category score so that the company's reputation is maintained.

Table 6 Category Value Controversy for Registered Companies in Indonesia

Category	Number of Companies	Percentage (%)
0	53	67,09
1	9	11,39
2	12	15,19
3	1	1,27
4	4	5,06
5	0	0
Total	**79**	**100**

Source: data processed, 2024

Descriptive statistical testing of 79 companies in Indonesia that have ESG scores shows a tendency to be considered to have medium to severe ESG risks. ESG scores show how a company's risk impacts the environment, society, shareholders and corporate governance itself. Putra & Adrianto (2020) concludes that companies that comply with sustainability have better performance and governance than those that do not. Priandhana (2022) also proves that the higher the company's risk, the lower its financial performance will be. However, Firmansyah et al., (2023) found that in Indonesia, ESG risk is not important information in assessing the condition of companies in the capital market. Furthermore, (Ramadhan et al., 2024) found that although the Sustainability Report revealed that the ESG Risk Score is an indicator of the quality of ESG Risk Management and is used to track the progress of SDG and ESG programs in the Indonesian capital market, it has not had a significant impact on company assessment evaluations. In line with stakeholder theory, ESG practices are important to meet stakeholder needs. Thus, the ESG Score is able to show the company's performance, but the ESG score becomes even more important when investors analyze their investment potential in the future so that it cannot be ignored by the company.

CONCLUSION AND RECOMMENDATION

This paper identifies ESG implementation in Indonesia. From the results of the search, testing and analysis, it can be concluded that even though the OJK has made policies related to sustainability reporting, ESG reporting in Indonesia is still low. ESG scores in Indonesia are dominated by high and severe risk levels. ESG scores become important when investors analyze their investment potential in the future so they cannot be ignored by companies. ESG assessments still need to be improved and refined regularly. This paper is limited to the list of ESG scores contained in the Indonesian stock exchange. It is possible that there is data that has not been updated by the Indonesian stock exchange. Suggestions for similar research are to compare data on the Indonesian Stock Exchange and Sustainalytics so that more comprehensive company data is obtained.

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