CHAPTER I

INTRODUCTION

1.1 Research Background

The globalization age has made economic development in the world increasingly integrated. This also impacts the business world which continues to grow rapidly in making changes. With globalization, companies are required to quickly adapt to shifting market dynamics and increasingly diverse consumer needs. This encourages innovation and productivity, and companies must be able to compete locally but also internationally. Therefore, globalization is the primary driver for companies to transform and enhance their competitiveness in the global market continually.

Globalization is crucial in enhancing a country's economic growth, as evidenced by the significant growth of gross domestic product (GDP). According to the BPS-Statistics Indonesia (2024), Indonesia's economy showed a significant upward trend in 2019-2023, although it declined in 2020 due to the COVID-19 pandemic. The process of globalization has expanded market access for local products, allowing Indonesian companies to compete at the international level. Therefore, the increase in GDP across various countries reflects the benefits of engaging in the global economy, where access to technology and innovation is increasingly available.

One of the things that propels economic growth is competition. Companies must improve performance efficiency, adapt, and innovate in increasingly tight competition conditions to maintain competitiveness. The competition forces the company to develop more forward and improve performance to achieve company goals oriented towards maximizing profits and achieving its primary goal of maximizing company value, which will increase welfare and prosperity for owners or shareholders (Rahmi & Wijaya, 2022).

In addition, Indonesia's increasingly tight economic growth requires companies to implement effective strategies to maximize their performance, aiming to achieve high levels of profit and shareholder satisfaction (Munawwaroh et al., 2021). When investing in businesses, price movements are important because the stock price index allows investors to view data directly, including the company's financial data, which shows how well the business is doing economically (Seviona & Haryati, 2024).

Rational investors tend to choose companies that demonstrate good performance for their investments. The performance of this business is used to determine how much shareholder satisfaction may be increased (Munawwaroh et al., 2021). Companies that focus on improving operational and financial performance enhance profitability and attract more investors, increasing their market value. Therefore, company management must prioritize performance improvement strategies for sustainability and long-term growth. Companies must make internal improvements and enhance their competitive capabilities to improve quality.

Financial and non-financial disclosures are essential in influencing a company's performance. Enterprise Risk Management (ERM) and Environmental, Social, and Governance (ESG) are examples of non-financial disclosures that provide information about how a company manages risks and its social and environmental impacts. One of the most important components of financial disclosure indicators is free cash flow (FCF). It offers a comprehensive view of the business's financial situation and capacity to sustain long-term expansion. A company is considered better if it can provide broader information disclosure, which indicates its ability to apply the principles of openness or transparency (Siregar & Safitri, 2019). Making an investment based only on financial data from financial statements does not ensure that the choice was the right one. A company that consistently presents excellent financial reports does not necessarily ensure the continuity of its operations. Financial information is insufficient as a basis for assessing a company. Therefore, disclosing non-financial information is also deemed necessary in investment decision-making considerations to provide a more comprehensive view, empowering investors with a more informed and confident approach (Devi et al., 2017).

Various perspectives can be used to define, explain, classify, and understand risk. According to the ISO 31000 definition, risk is the outcome of weighing the likelihood of an event occurring against its potential repercussions. To put it simply, risk is the result of multiplying likelihood by impact. According to Hansa and Ridaryanto (2024), risk is the unpredictability of anticipated and unforeseen circumstances that could have a detrimental effect on a business's operations and results. The outline of risk among experts ranges from deviations in the values of financial variables to various types of planned or strategic variables (Jawad et al., 2021). Generally, risk can be defined in various ways, for example, risk can be defined as an adverse event or as a deviation from expected outcomes for investment analysts. Regardless of the definition of risk, it encompasses at least two important aspects: probability and loss/impact (Arifudin, O., Wahrudin, U., & Rusmana, 2020).

Risk is an integral component of all organizations. If not handled appropriately, changes in the internal and external surroundings can have detrimental effects on businesses. Investors receive a positive signal from a company that has successfully controlled its risks when it employs risk management and discloses its risk profile. Risks arising from both inside and outside the company can affect profitability and make it difficult for companies without good risk management to maintain their business continuity (Monica & Sudjiman, 2023).

Companies that do not innovate and fail to face challenges will likely to stagnate and can be surprised to face competition or lose customers. Failures in risk management, particularly in large companies, have been a major concern across various sectors for many years. This was an example by Silicon Valley Bank (SVB), which experienced a failure in risk management due to its inability to manage interest rate and liquidity risks, and a lack of oversight regarding these risks (Rossi, 2023). PT Asuransi Jiwasraya also experienced similar issues, characterized by poor investment risk management and weak governance (Sutrisno et al., 2021). It is crucial to remember that good risk management involves managing hazards as a motivator for business and entrepreneurship rather than completely avoiding them.

Furthermore, the importance of strengthening risk management practices has become one of the valuable lessons from financial crises, both for companies in the financial and non-financial sectors (Kurniawan et al., 2024). This indicates that effective risk management is not only relevant for financial institutions, but also essential for businesses across a range of other industries to guarantee the stability and sustainability of their operations. Consequently, ERM has become essential for firms to recognize, evaluate, and control potential hazards (Seviona & Haryati, 2024). ERM was initially suggested by the Treadway Commission's Committee of Sponsoring Organizations (COSO) in 2004 as a process that should be included in any business's plan to help achieve organizational objectives. ERM is made up of five parts: information and communication, monitoring activities, control actions, risk assessment, and the control environment. It is described as a practice, culture, and capacity that are combined with strategy formulation and execution. ERM is used by organizations to efficiently manage risks while generating, maintaining, and maximizing value (COSO, 2020).

Companies can identify and assess potentially harmful risks by implementing Enterprise Risk Management (ERM). This enables the company to manage those risks effectively, to improve overall performance. Implementing ERM assists management in meeting performance and profitability targets while safeguarding resources. The COSO ERM framework and ISO standards provide a structured method for executing enterprise-wide risk management (Otero González et al., 2020).

Numerous studies conducted previously show a range of results regarding the impact of enterprise risk management (ERM) on firm performance. Some studies indicate a significant positive relationship, while others find no clear influence. Company performance, including financial and market performance, is significantly improved by enterprise risk management, according to study by

Anugerah et al. (2023), Florio and Leoni (2017), Horvey and Ankamah (2020), and Malik et al. (2020). ERM based on ROI significantly improves both financial and market performance, but ERM based on ROA has a good impact on financial performance but no beneficial impact on market performance, as research by Samudera and Husaini (2023). However, the outcomes of research by Emar and Ayem (2020), Kurniawan et al. (2024), Otero González et al. (2020), and Rahmi and Wijaya (2022) reveal that ERM has no obvious positive influence on corporate value. Even though ERM is meant to improve corporate performance, this study's empirical findings show that its implementation does not always have a significant impact.

Actively assessing the outcomes of an organization's environmental, social, and governance (ESG) programs is more crucial than ever. Sustainability has become a primary goal as companies develop plans to address issues including pollution, water use, and climate change. Additionally, businesses are now expected to address matters related to labour rights, the activities of supply chain partners, and the effects of their operations on communities. As a result, new sustainability regulations and initiatives require organizations to systematically monitor and manage these responsibilities (Boulhaga et al., 2023).

ESG are important factors that contribute to company performance. The significance of corporate performance also enables companies to utilize resources effectively in facing environmental changes (Faisal et al., 2018). Misuse of resources to achieve high profits often leads to environmental damage. A sustainable investing method becomes essential to understand more about companies that consider sustainable environmental and social repercussions in their operations.

The United Nations Environment Programme Finance Initiative (2021) states that in order to generate long-term value, sustainable investment takes into account environmental, social, and governance (ESG) factors in addition to other factors like stability. Before making an investment, investors can utilize ESG criteria as a guide to include sustainability issues (Antonius & Ida, 2023).

The results of several previous research on how ESG affects company success differ. ESG significantly and favourably affects business performance, according to research by Safriani and Utomo (2020), Antonius and Ida (2023), Bahadori et al. (2021), and Boulhaga et al. (2023). It is regarded as one of the significant influencing factors when taking ESG factors into account. Nonetheless, study by, Ningwati et al. (2022) demonstrates that ESG significantly reduces corporate value rather than increasing it.

In addition, free cash flow (FCF) is also an important factor company performance. FCF shows the cash available after the company has met all its spending needs. The more free cash flow a corporation has, the better it represents its operations (Rahmi & Wijaya, 2022). Consequently, it demonstrates that the company has sufficient funds to settle debt, reinvest, and provide dividends to shareholders. Additionally, various conclusions from past research on the effect of free cash flow on company performance were brought forth. Studied by Rahmi and Wijaya (2022) and Zurriah (2021) show that free cash flow significantly affects business performance. According to Muzakki and Gandakusuma (2023), free cash flow has no discernible beneficial impact on business performance.

As a result, financial data not only helps with strategic decision-making but also gives stakeholders assurance about the company's future growth and sustainability prospects. When financial and non-financial disclosures are combined, a more thorough picture of the business's entire performance is produced.

There are inconsistencies in previous studies regarding firm performance due to variations in the years, countries, and sectors examined. Unlike prior research, which typically focused on a single primary variable, this study incorporates three key variables. Additionally, this analysis examines the present research period and includes all non-financial companies listed on the Indonesia Stock Exchange (IDX), in contrast to other studies that typically focus on certain industries. Investigating the effects of enterprise risk management (ERM), environmental, social, and governance (ESG), and free cash flow (FCF) on firm performance is the aim of this study. Additionally, this study incorporated control variables like company size, leverage, and growth to ensure that external factors wouldn't change the relationship between the independent and dependent variables.

1.2 Problem Formulation

Based on the previously provided research background, the research challenge is formulated as follows:

1.2.1 Does Enterprise Risk Management (ERM) affect firm performance in the non-financial companies listed on the IDX 2020-2023?

1.2.2 Does Environmental, Social, and Governance (ESG) affect firm performance in the non-financial companies listed on the IDX 2020-2023?

1.2.3 Does Free Cash Flow (FCF) affect firm performance in the non-financial companies listed on the IDX 2020-2023?

1.3 Research Objectives

The following are the study's goals, which are based on the problem formulation mentioned above:

1.3.1 To investigate the effect of enterprise risk management on firm performance in non-financial companies listed on the IDX 2020-2023.

1.3.2 To investigate the effect of environmental, social, and governance on firm performance in non-financial companies listed on the IDX 2020-2023.

1.3.3 To investigate the effect of free cash flow on firm performance in non-financial companies listed on the IDX 2020-2023.

1.4 Research Benefits

The goal of the study is to support the relevant stakeholders both theoretically and practically. The findings of this study are intended to improve understanding of how corporate risk management, free cash flow, environmental, social, and governance factors affect firms' success. Furthermore, it is anticipated that this study would provide significant insights and references for further research. The results will support companies in shaping their policies, making informed decisions, and implementing corporate responsibility initiatives to enhance performance by identifying the factors that influence firm performance.

1.5 Writing Systematic

Researchers used a systematic writing framework consisting of five consecutive chapters to organize the debate in this study. The first chapter, which acts as the introduction, explains the research background, problem formulation, research aims, research advantages, and writing systematics. The theoretical underpinnings and prior research that served as a guide for the theoretical underpinnings, analysis, and development of hypotheses are presented in the second chapter. This chapter then presents the conceptual framework and hypothesis generation. The type of research, demographic and research samples, sampling strategies, data types and sources, data collection strategies, variable identification, and data analysis strategies are all covered in the third chapter.

The study's fourth and fifth chapters are crucial since they give a comprehensive rundown of the complete research process. The study results are provided in the fourth chapter using statistical testing and hypothesis proof, which can be validated by the research's conclusions and responses. The fifth chapter serves as a conclusion and includes findings drawn from all of the earlier chapters, the researchers' limitations, and recommendations that might be helpful to readers.