

CHAPTER I

INTRODUCTION

1.1 Background of the study

Environmental issues are currently a popular topic among many parties, especially academics and practitioners. Given the current state of the environment, which is quite alarming due to global warming, which is a global threat. According to Calvin et al. (2023) in the IPCC report, it is noted that between 2011 and 2020, the temperature at the earth's surface has reached 1.1°C above the industrial average. Based on the available data, we can see how the current environmental conditions continue to decline in quality. Furthermore, this increase in temperature is not just data and statistics, but will also have a real impact on our lives and our planet (Ahmad Arif, 2024). In response to the environmental phenomena currently occurring, many international bodies such as the Paris Agreement have set targets to limit the rise in global average surface temperature to below 1.5°C. This is to achieve the goals governments and corporations are required to commit to net zero emissions (Figuerola-Ferretti et al., 2025). Therefore, to face this challenge, cooperation between countries and companies is needed to reduce greenhouse gas emissions, carbon emissions, and focus more on socially and environmentally sustainable economic development.

This issue of sustainability has become a concern for many parties around the world, with the increase in current global challenges as well as climate change and social imbalance (Trudeau, 2018). Therefore, the United Nations Principles for Responsible Investment (UNPRI) introduced the concept of ESG (Environmental, Social, and Corporate Governance), which has become a globally recognized standard for evaluating corporate sustainability. In recent years, many regulatory bodies have attempted to develop policies that encourage companies to fulfill their ESG responsibilities. As explained by Sun et al (2025), ESG ratings reflect a company's

commitment to developing sustainability and social responsibility. Studies have shown that strong ESG Performance is not only enhances reputation, but also improves financial stability and long-term resilience (Deng et al., 2013). Thus, ESG performance is not a tool for assessing corporate social responsibility, rather than a strategy for achieving sustainable development that can create long term value (X. Sun & Xiong, 2025).

In response to this, many countries around the world have begun to develop their sustainability performance. This starts with improving ESG disclosure systems in the form of sustainability reports to reveal their social and environmental responsibilities (K. Chen & Xie, 2025). A survey related to sustainability reports was conducted by one of the world's largest public accounting firms, Klynveld Peat Marwick Goerdeler (KPMG). According to a survey conducted by KPMG (2022), it was found that 79% of N100 companies (100 large companies from 58 countries) have reported sustainability data. Meanwhile, 96% of the 250 largest companies globally reported sustainability data in 2022 (KPMG, 2022).

The increasing reporting of ESG by large companies globally has changed the perspective of investors and other stakeholders. Good ESG performance results in a positive reputation, attracts more investors, and increases social recognition, which is long-term in nature (Huang & Zhang, 2025). This is because ESG performance has become a tool for shareholders and stakeholders to evaluate company performance (Pan et al., 2025). In addition to being an evaluation tool, ESG performance disclosure also reflects the comprehensive development status of a company, which will be a major concern for all stakeholders (Bai et al., 2022). Good ESG performance indicates less asymmetric information disclosure and is also able to reduce risk and facilitate financing for companies (Bai et al., 2022). Good performance will also attract the attention of many media outlets, and the positive information presented by the media will increase market influence and strengthen the company's reputation (Bai et al., 2022).

Indonesia is one of the countries with extraordinary biodiversity, but environmental pollution and declining ecological levels are quite concerning (Xaviera & Rahman, 2023). This is a cause for concern for the community, therefore sustainable practices and environmental management are needed to reduce negative effects (Xaviera & Rahman, 2023). In relation to this issue, POJK Regulation No. 51/POJK.03/2017 on “The Application of Sustainable Finance for Financial Institutions and Public Companies” was issued, with the obligation to publish sustainability reports with a two-year grace period for preparation. Thus, Indonesian financial service providers are required to submit sustainability reports or sustainable finance action plans (RAKB) since 2019. Companies are required to publish sustainability reports from 2020 onwards. Although there are clear regulations regarding this matter, it does not work as it does in developed countries where sustainability practices are highly regarded by stakeholders. Meanwhile, in developing countries, this matter is only dominated by external parties such as foreign investors and international agencies (Xaviera & Rahman, 2023).

We can see this from the 2023 data, which shows a 97% increase in sustainability reporting from 873 listed companies (Indonesia Stock Exchange, 2024). In addition, IDX Development Director Jeffrey Hendrik (2024) stated in an Antara News article (2025) that this is a form of financial disclosure based on sustainability principles. However, there are still a few areas that could be improved in term of transparency and performance. Therefore, the data presented above can serve as a basis for investors in making investment decisions that prioritize climate change considerations (Jeffrey Hendrik, 2024) in (Antara News, 2025).

However, these improvements in sustainability reporting do not mean that environmental problems have been solved. There are still many environmental issues, such as deforestation in Indonesia, which increased by 175,400 hectares in 2024 (Ministry of Environment and Forestry, 2024) (Kalamanthana, 2025). In addition, Indonesia ranks second as the country with the highest emissions in the world, with

average emissions reaching 930 million tons, contributing 19.9% of total land use change (Danur Lambang Pristiandaru, 2023). According to the 2024 Emission Gap Report, Indonesia remains a major contributor to carbon emissions through coal use and deforestation, which pose obstacles to Indonesia's climate targets (Kahfi, 2025). In addition, at the end of 2025, floods and landslides occurred in several provinces in Sumatra. This was worsened by environmental degradation and deforestation in river basins, which shows that serious environmental damage continues to occur even though many companies report ESG performance (Suhendra Dio, 2025) in (The Jakarta Post, 2025).

Based on cases that show how ESG practices in Indonesia are still far from ideal. In addition, this fact shows that even though companies are increasingly compliant in publishing ESG reports, the results and facts on the field are still far from optimal and still show major problems that are not fully reflected in ESG reporting. This creates a gap between the reports produced and the actual performance in the field. One factor that can explain this condition is that companies are currently facing challenges in cash flow and value creation. This requires companies to be flexible and adaptive to uncertain market changes (Pan et al., 2025). In this context, financial flexibility reflects how companies are able to respond to sudden and unexpected needs and opportunities that arise in the future through the availability of adequate financial resources (Akbar & Setiana, 2024). Substantial ESG implementation, such as investment in environmentally friendly technology, energy efficiency, waste management, and governance strengthening, requires long-term funding and often does not generate immediate financial returns in the short term.

In addition to internal factors such as financial flexibility, this study also considers external factors originating from the competitive market environment at the company level. Corporate financial management is indeed an important aspect in driving ESG performance improvement, but the position and strength of the company in facing its competitors also determine the sustainability strategy adopted. This condition is

reflected in the concept of company-level market competitiveness within its operational area (T. Zhang et al., 2025). Indicators such as the scope of operations, the number of entities managed, and expansion and acquisition activities can reflect the complexity of the competitive environment faced by the company (T. Zhang et al., 2025). Empirical findings show that company-level market competitiveness can affect ESG performance, although the direction of the influence is still inconsistent. Most companies that operate in intensely competitive industries tend to use differentiation strategies. However, high competitive pressure can also make companies more focused on cost efficiency and short-term financial performance, thereby potentially reducing the allocation of resources for long-term ESG investments (T. Zhang et al., 2025). Therefore, company-level market competitiveness is an important factor that can determine the degree to which companies demonstrate commitment to improving ESG performance.

Previous studies have explored very little about how corporate financial flexibility affects ESG performance. Research carried out by (Pan et al., 2025) highlights that financial flexibility can help companies maintain sustainable investments, especially in conditions of uncertainty. However, there are still several gaps in this study, including findings that are still based on specific market contexts, which in this study highlight companies in developed countries such as China. Of course, this will be irrelevant to market conditions in developing nations such as Indonesia. Moreover, the study limited focusing only internal company factors and does not consider external factors. Another study conducted by Zhang et al. (2020), which examined the relationship between financial flexibility and sustainability, still focuses on financial performance and market returns. This study also only focuses on the external aspects of the company.

This study departs from the gap in previous studies, which only highlighted one side, namely the internal or external side. Therefore, this study combines these two sides, where financial flexibility highlights the internal side of the company, while market competitiveness highlights the external side of the company. This study also

highlights non-financial public companies in Indonesia, which is a developing country, as this is one of the gaps in previous studies. The non-financial sector is the object of this study because it has significantly different financial structure characteristics, business models, and reporting regulations compared to companies in the financial sector (T. Zhang et al., 2025). In addition, referring to the findings of the World Resources Institute (WRI) Indonesia, the direct contribution of carbon emissions generated by activities in non-financial sector companies accounts for 34% of total national carbon emissions (Astuti Rima Dwi, 2025). The significant contribution of companies in the non-financial sector to these emissions shows that the environmental sensitivity of the non-financial sector is relatively greater than that of the financial sector. In addition, another consideration relates to the consistency of companies in reporting their ESG performance. There are 60-75 sample companies in the non-financial sector that have good and consistent ESG performance (Estetika Mutiaranisa Kurniawati, 2025).

The observation period for this study covers the years 2020-2024, as this is an important transition period in the adoption and reporting of ESG in Indonesia. In addition, these years were chosen to observe the response of business actors to regulatory changes, post-pandemic dynamics, and increased market awareness of corporate sustainability.

1.2 Research Questions

Based on the previously outlined background, the primary research question of this study are outline as follows:

RQ1. Does cash flexibility affect ESG performance?

RQ2. Does debt flexibility affect ESG performance?

RQ3. Does company-level market competitiveness affect ESG performance?

1.3 Research Objectives

Based on the background and problem formulation, the objectives of this study are as follows:

- RO1. To determine whether cash flexibility affects ESG performance
- RO2. To determine whether debt flexibility affects ESG performance
- RO3. To determine whether company-level market competitiveness affects ESG performance

1.4 Implication of the Study

This study is expected to have the following implications:

1. Implications for theory.

This study investigates the relationship between internal company factors, particularly financial flexibility and company-level market competitiveness, and ESG performance. The findings explain that companies with strong and competitive resource capacities tend to take the initiative in sustainability development. This is especially true in the energy sector of developing countries such as Indonesia, which is still relatively limited compared to other developed countries.

2. Implications for academia

This study is expected to make a meaningful contribution and provide a strong literature base for further research. By considering and addressing the limitations of this study, it will help provide even more in deeper insights. To examine the factors that influence ESG performance that are more in line with the actual situation.

3. Practical Implications

The research will help companies in Indonesia engaged in the energy sector. To increase financial flexibility as a form of success in financial performance management. As well as strengthening market

competitiveness in order to improve ESG performance to assist in sustainable development.

1.5 Writing Systematic

The researcher designed this study using a systematic writing framework, and the study consist of five chapters. The first chapter of this study, titled “Introduction”, begins with the background, research objectives, research benefits, and the structure of the study. The second chapter, which discusses the “Literature Review”, this chapter will focus on the theoretical framework and prior research that will act as the basis for this study and the development of hypotheses. It includes a conceptual framework that will support the research. The third chapter of this study discusses “Research Methodology,” this chapter will outline the research design, population, and sample selection, while also explaining the sampling techniques to be used. It also covers source of data, method of data collection, variable identification, and analysis techniques.

The fourth chapter, “Research Results and Discussion,” addresses the research questions, followed by the fifth chapter, “Conclusion”, wich provides a summary and conclusions regarding the result of the discussion, the study’s limitations, and provide several recommendations for readers.

