The Mediating Effect of ESG Performance on Board Structure and Financial Performance: Evidence of Indonesia

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Abstract
This study offers fresh data on the significance of corporate location in CSR reporting from nine developing nations, together with a review of the environment's present status and how eco-friendly behaviors and attitudes might preserve the planet. The Bloomberg database was used to gather environmental, social, and governance score data for the years 2013 through 2020. This study concludes some findings. First, independent members have an effect on the company's financial success. Second, independent boards do a lot of damage to ESG. The third thing is that the ESG may lessen the effect that independent members have on financial performance. The findings of this study will benefit any country where sustainable green practices are uncommon and the ecosystem deteriorates on a daily basis.

Keywords: ESG performance, board structure and financial performance

Introduction
High financial performance is always a concern for every manager, because financial performance has an important position in the structure and development of a company. However, this goal is sometimes hindered by several factors that lead to low corporate performance. Studying the determinants of financial performance is necessary for companies, as the available management literature shows that there must be an effective board structure for better performance (Kyereboah-Coleman & Biekpe, 2006). Kusi et al. (2018) Demonstrate that in Africa, Board Structure (BS) can either enhance or diminish the maximization of shareholder and stakeholder value, albeit its impact on shareholder value maximization is more significant. In indonesia, Ifada et al. (2021) showed that the social reporting is positively influenced by board size. Meanwhile, Dalton & Dalton, (2011) and Agoraki et al., (2010) Asserted that there is a lack of empirical evidence supporting a causal connection between Board Structure and company financial performance.

A graph of changes in financial performance, as represented by the return on assets (ROA) of public companies in Indonesia from 2013 to 2020, is presented by the researcher. It is assumed by the researcher that ROA fluctuations are unpredictable. Due to this uncertainty, investors are always made cautious before investing their wealth. Therefore, a method or analysis needs to be implemented. Because of this uncertainty, investors are always cautious before investing their wealth. Therefore, a method or analysis needs

to be done. The following is a graph of changes in ROA of Indonesian public companies as a sample presented. Based on Figure 1, the average ROA graph tends to decline so that researchers are motivated to conduct further research related to this topic.

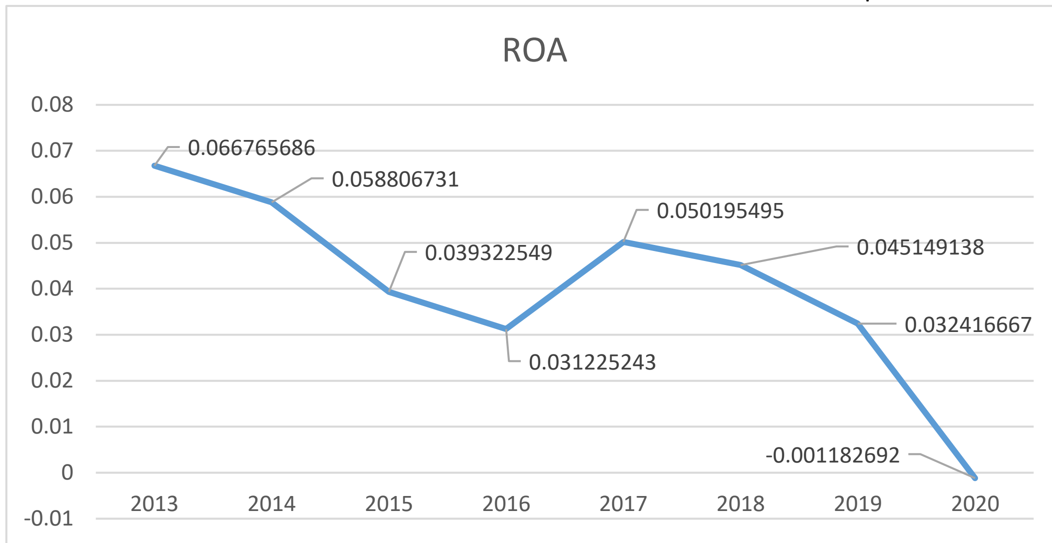


Figure 1. Average ROA of Indonesian companies for 2013 – 2020

Source: Researchers' construction based on Bloomberg database (2022)

Concerns related to the environment have emerged as a significant subject in the present-day worldwide economic landscape (Ifada et al., 2021). In addition, environmental strategy is increasingly becoming part of business practice and research. The world has experienced extraordinary natural debasement, which has genuinely influenced people's ordinary lives. Subsequently, the rise of corporate social duty and supportability places directors and the ancient shareholder-manager-creditora vision beneath weight from the corporate social environment (Ifada et al., 2021). By appearing the linkage between non-financial and monetary data, natural divulgence as a methodology looks for long-term changes in a company's competitiveness.

More specifically, "Green Bonds" have become an alternative and important way for environmentally conscious businesses to get money. As a result, the amount of "Green Bonds" issued each year has grown from about $40 billion in 2014 to over $160 billion in 2018 and will reach $1.02 trillion in 2021. Furthermore, Flammer et al., (2020) discovered that backers' Green Bonds advance their natural execution (post-issuance), specifically through reducing CO2 emissions and raising the company's environmental rating (Winarsih et al., 2022). In line with Bloomberg data, Figure 2 shows that the trend of ESG (Environmental, Social, and Governance) also increased from 2013 to 2019. However, a decline occurred in 2020, most likely due to the COVID-19 pandemic. Nonetheless, the outlook for continued growth of the ESG market in Indonesia remains positive, driven by increasing awareness of the importance of sustainability and government support for green initiatives.

According to Galbreath (2013), Research on Environmental, Social, and Governance (ESG) is still scarce because most studies try to establish a connection between ESG and corporate financial performance, but they fail to take corporate governance mechanisms into account when disseminating ESG disclosures, and thus overlook their impact on financial performance (Manita et al., 2018). ESG objectives have

presented new managerial and scientific difficulties for a number of fields. The relationship between ESG divulgence and execution has been broadly investigated within the writing (Fatemi et al., 2018). Be that as it may, small is known approximately the components that drive ESG revelation (Baldini et al., 2018)

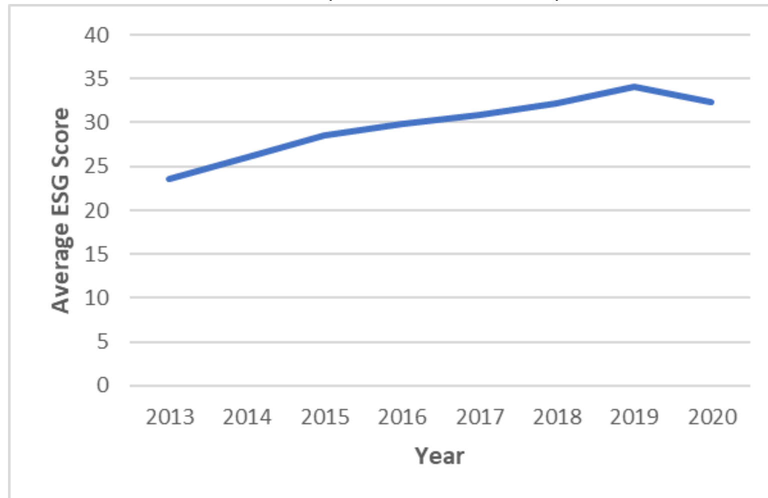


Figure 2. Average ESG of Indonesian companies for 2013 – 2020

Source: Researchers' construction based on Bloomberg database (2022)

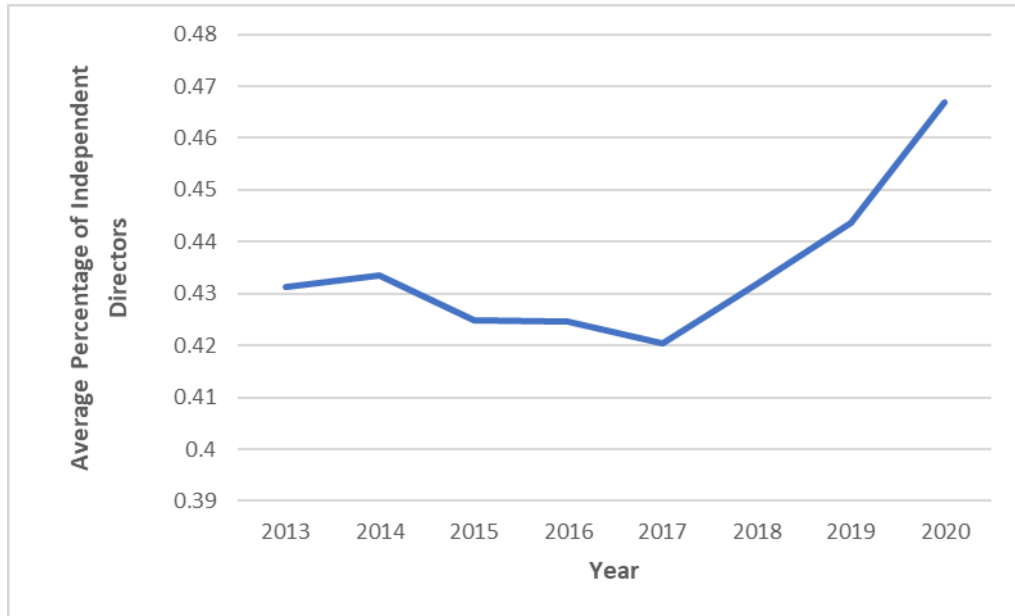
Galbreath, (2013) contends numerous viewpoints of administration (For example, committee autonomy or board structure) endure from a need of strength. As specified some time recently, the writing primarily centers on natural measurements (Liao et al., 2015). Furthermore, a number of studies have looked at how women's positions as directors on boards contribute to CSR. Numerous scholarly works have thoroughly investigated and deliberated about the correlation between corporate governance and social involvement and reporting standards; nonetheless, the focus has predominantly been directed towards industrialized western nations (Arayssi et al., 2020). The results of this study offer an important contribution, highlighting seemingly inconsistent results in the literature. The main goal, as mainstream disclosure studies argue, is that to meet stakeholder needs in terms of increasing transparency, satisfying the decision needs of interested parties entingan (Ifada et al., 2021; Jizi, 2017).

According to their findings, financial experts are no longer able to predict abnormal profits for moo or tall ESG companies. Auer & Schuhmacher, (2016) consider geographic districts and businesses and appeared that financial specialists in Europe pay a premium for socially dependable speculations compared to speculators within the Joined together States and the Asia-Pacific locale. Assenga et al., (2018) and Tan et al., (2019) It seems that the fact that the Board of Executives is made up of two men and one woman is bad for business, but things like board size, the percentage of free people and the quality of education are good for business.

The main focus of this study is independent directors as it is based on available data. Figure 3 illustrates the trend of independent director presentation in the Bloomberg database, which tends to fluctuate from 2013 - 2017 but has increased from 2017 - 2020. In contrast, the ESG trend (Figure 2) tends to increase every year and the ROA trend (Figure 1) tends to decrease every year. In conclusion, the graph between independent

directors and financial performance represented by ROA shows the opposite direction so it is interesting to be tested further.

Figure 3. Independent director graphic for 2013 – 2020



Source: Researchers' construction based on Bloomberg database (2022)

This research has some contributions. To begin with, most inquire about discoveries on board differences and CSR divulgence are centered on created economies (Bear et al., 2010; Harjoto et al., 2015; Jizi, 2017; Rao & Tilt, 2016) while we offer observational prove from Indonesia which is creating nations where the composition of the subjects of board freedom, ESG execution and money related execution are not broadly investigated. ESG Score Testing is useful because a lot of research now concentrates just on environmental (Ifada & Jaffar, 2023; Ifada & Saleh, 2022; Wardhani et al., 2022; Rini & Adhariani, 2021 Majid et al., 2020) or social (Qiu et al., 2016). The third choice of ESG as a mediating variable is because it is possible that ESG Performance plays a role. By prioritizing ESG performance, independent directors ensure that the company operates sustainably by reducing environmental impacts, improving employment practices, and encouraging diversity (Dewi et al., 2022).

These discoveries might be especially illustrative of companies in creating and industrialized nations that still take after unsustainable conventional hones. The ponder comes about are advantageous for any nation where economical green hones are not common and the natural circumstance is declining day by day. These findings support the need to investigate the causes of the current environmental crisis and the ways in which environmentally conscious practices and attitudes can save the planet. Since developed economies provide the majority of our knowledge about CSR disclosure, studies of emerging countries are crucial both theoretically and empirically.

Agency theory states that as independent directors are best prepared to supervise the agency's decisions, they should hold the majority of board slots. Board independence may play a critical role in monitoring and regulating issues related to sustainable

development. It is predicted that independence will provide new perspectives on environmental and social issues, in contrast to existing models that simply take financial success into account (Sun et al., 2010).

Company performance will increase if an independent board reduces agency costs and protects shareholder interests (Bhat et al., 2018; Ifada & Indriastuti, 2021). Research revealed by previous studies (Kao et al., 2018); (Merendino & Melville, 2019) that the smaller the number of boards, the more effective and maximum supervision is carried out on management. A study revealed that an increased number of external board of commissioners with diverse experiences and expertise in a company can lead to a decline in their ability to effectively supervise due to the emergence of communication, coordination (Pillai & Al-Malkawi, 2018). The company's financial performance may be impacted by agency expenses incurred to address conflicts of interest between agents and principals as a result of this governance issue. Various outcomes were disclosed by (Mishra & Kapil, 2018) that independent directors reduce company performance by making decisions that do not maximize company performance to secure the interests of controlling shareholders.

H_1: Independent Directors have a positive effect on financial performance.

Haque, (2017) More variety in terms of stakeholder participation may be fostered by striking a healthy balance between the organization's financial and non-financial objectives. This diversity—often linked to independent boards—can be crucial to addressing potential conflicts of interest between various stakeholder groups. The study's conclusions show that an organization's environmental performance is positively and significantly impacted by the size of the board. As a result, there is little data about how board size affects corporate environmental performance in developing markets, especially in China (Zou et al., 2019).

Non-financial information appears to be driven by the growth of independent directors, which supports the need for most boards to have more independent directors in order to comply with the Governance Code. Furthermore, boards with environmental committees are expected to be more responsive to the environment (Peters & Romi, 2014). In an analysis conducted by Kent & Monem, (2008) It was demonstrated that there was a substantial and favorable correlation between the existence of an environmental committee and ESG scores. As a result, the presence of this committee will cause some components of this governance structure to become more significant. In this way, independent directors can help companies build environmental credibility and legitimacy (Ifada et al., 2023).

H_2: Independent Directors have a positive effect on ESG Performance.

These practices can lead to improvements in the business itself, a competitive edge, and enhanced reputation (Bui et al., 2020). Ning et al., (2021) and Xie et al., (2019) Give instances like how resource conservation and contented workers can boost productivity, which can then spur innovation. Concurrently, this can improve financial performance by cutting out unneeded expenses and raising earnings as a result. Despite the fact that some ESG subcategories have contradictory findings regarding business value and profitability (Ifada et al., 2021), Overall, there is a correlation between increased levels of ESG disclosure and improved financial success.

H_3: ESG performance has a positive effect on financial performance.

ESG ratings categorize the enhanced value of CSR performance achieved through various environmental, social, and governance efforts. Companies that reach higher levels of ESG demand more investment since the conditions in emerging countries differ from those in established markets. As a result, businesses need to commit significant financial resources to bolstering their ESG procedures. Previous studies show that ESG can positively influence FPs both directly and indirectly; thus, it can increase a company's competitive advantage as well as shareholder value (Bernardi & Stark, 2018; Li et al., 2018). Improved reputation and brand image appear to be among the advantages of corporate involvement in ESGD, helping businesses to perform effectively during the crisis (Kiryanto et al., 2021). Prior research revealed a strong favorable correlation between CSP and business financial performance (Famiyeh, 2017).

Strong corporate governance and a high standard of social performance enable businesses to sustain consistent profitability and less erratic stock prices (Lee, 2016). Popli et al., (2017a) and Popli et al. (2017b) discovered that businesses are best positioned to slow down the decline in their profitability when they align their reactions with changes in the external environment. Consequently, in order to make money, environmental disclosure is required. Furthermore, social interactions need to be expressed both formally and informally.

H^4: ESG performance has an impact on the link between financial performance and independent directors. The Conceptual Framework is described in Figure 4.

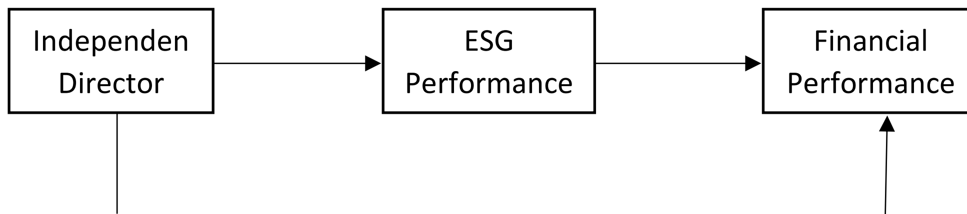


Figure 4. Conceptual Framework

Source: Processed Data, 2022

Research Method

This study used Indonesian public companies recorded in the Bloomberg database in 2013 - 2020. Indonesia is regarded as a developing nation because of its rapid economic growth and likelihood of becoming a developed nation soon. The choice of 2013 – 2020 was due to several reasons. *First*, we have now entered a new normal era, so we chose the pre-Covid era period. *Second*, to avoid bias in results during crises and times of crisis.

Financial performance refers to the evaluation of a company's performance during a specific period, typically assessed using Return on Assets, an accounting-based metric. The independent variable is Independent Director. Corporate governance variables refer to particular characteristics of a board, such as its size, level of independence, and gender mix. The research measures GCG through the independent variable of board composition (BI).

The extra value of CSR performance that results from numerous environmental, social, and governance initiatives is known as ESG scores (Brooks & Oikonomou, 2018). We use Bloomberg's ESG data as a stand-in for assurance and voluntary disclosure. Most

people believe Bloomberg's ESG data to be a reliable and accurate indicator, despite the fact that it is a private statistic.

In this study the authors did not use control variables for several reasons First, over-controlling with too many control variables can weaken statistical power and cause bias. Second: The existence of relationships that arise due to control variables can increase standard errors and hinder the interpretation of results. Under these circumstances, focusing on the mediating effect of ESG without additional control variables may provide a clearer understanding of the mechanism underlying.

The data analysis technique used was the E-Views Series 10 application and with Regression analysis's. To assess the data set, a number of traditional regression assumption tests were performed, including multicollinearity and heteroscedasticity. The Pearson correlation analysis was used to verify the correlation value in order to conduct the multicollinearity test. Four research models based on the requirements for testing the influence of mediators by Baron & Kenny (1986).

Result and Discussion

The final sample consists of 437 companies that have ESG, ID, ROA and ROE data for the period 2013 to 2020. Appendix 1 displays the allocation of sample enterprises according to their respective industries. There was an upward trend seen from 2013 to 2019, followed by a decline in 2020.

Table 1. Sample Criteria Results

Description	Amount
Businesses with ESG information	451
The firm lacks identification details.	1
Businesses with ID and ESG data	450
The firm lacks Return on Assets (ROA) statistics.	0
Businesses with ID, ROA, and ESG	450
Outliers	13
Companies that have ESG, ID, ROA data	437

Source: Processed secondary data, 2023

The detailed data for each variable are shown in Table 2. Financial success, which is the study's dependent variable, has a range of -0.183 to 0.487. There is a standard variation of 0.079 and the mean is 0.592 for this number. As you can see, the study is mostly about the independent variable of independent directors, which has a range of values from 0.2 to 0.800. It ranges from 0.436 to 0.124, with 0.124 being the measure of variance. From least to most, the ESG number is between 6,610 and 54,960 A standard variation of 11,790. is found for the ESG variable. Its mean value is 30.282.

Table 2. Descriptive Statistical Analysis

	N	Minimum	Maximum	Mean	Std. Deviation
Financial Performance	437	-0.183	0.487	0.059	0.079
Independent Directors	437	0.200	0.800	0.436	0.124
ESG	437	6,610	54,960	30,282	11,790

Source: secondary data processed, 2023

The probability value for normality is 0.544852, which is more than 0.05. Therefore, it can be inferred that the data follows a normal distribution. The number of

the Chi-Square chance in Obs*Rsquared is 0.7898, which means it is greater than 0.05. These findings suggest that there is no heteroscedasticity present in the data.

Table 3. Displays the results of the normality test, heteroscedasticity test and multicollinearity test

Normality Test					
			Statistics		Prob.
Skewness			1.069869		0.142339
Skewness 3/5			1.301840		0.096486
Kurtosis			1.109318		0.133646
Normality			1.214481		0.544852
Heteroscedasticity Test					
F-statistic		0.070747	Prob. F (1.434)		0.7904
Obs*R-squared		0.071061	Prob. Chi-Square (1)		0.7898
Multicollinearity Test					
Var	*ROA*	*ESG*	*ID*	Tolerance	VIF
ROA	1	0.021	0.168**		
ESG	0.021	1	-0.145**	0.979	1.022
ID	0.168**	-0.145**	1	0.979	1.022

Source: secondary data processed, 2023

The F test is employed to determine if the collective independent factors exert a substantial impact on the dependent variable. Based on Table 6, the Prob (F-Statistic) value is smaller than 0.05, namely 0.000, so this model is fit.

Based on the results obtained from partial testing (t test) which can be seen in table 6, it shows that Independent Directors have a coefficient value of 0.104 with P<0.001, which means that Independent Directors have an effect on financial performance. Based on these findings, H1 is accepted.

Table 4. Hypothesis Test Results

	Model 1	Model 2	Model 3	Model 4
	ESG	F.P	F.P	F.P
C	29,154***	0.060***	0.078***	0.029
ID	-11,859***	0.104***		0.117***
ESG			0.001**	0.001***
Industrial Dummy	YES	YES	YES	YES
R-squared	0.391	0.314	0.307	0.333
Adjusted R-squared	0.366	0.286	0.279	0.301
F-statistic	1,582	1,129	1,092	1,142
Prob(F-statistic)	0,000	0,000	0,000	0,000

Source: Secondary data processed, 2023.

The results of this research are in line with research conducted by leh (Alipour et al., 2019; Ifada et al., 2021; Kasbar et al., 2022; Wahyuningrum et al., 2020). This, in turn, results in improved financial performance for the company. Board independence positively influences financial performance by promoting enhanced governance, heightened supervision, enhanced transparency, and augmented shareholder value. Independent directors bring diverse skills and perspectives, challenge management

decisions, and provide balance in management practices. This encourages a culture of accountability, transparency and effective decision making, ultimately leading to improved financial performance. Board independence has a positive impact on return on assets (ROA) due to better governance, efficient oversight, stronger accountability and better strategy. Independent directors have diverse skills and experience, scrutinizing management decisions, monitoring financial health, driving transparency, and challenging assumptions to improve strategic planning and ultimately generate higher ROA. These decisions can impact the financial performance of the business and reduce conflicts within the organization (Suhendi et al., 2022; Wedari et al., 2022).

Moreover, Independent Directors has a coefficient value of -1.186 with a P Value < 0.01, which means that Independent Directors have a significant negative influence on ESG. Thus, H2 is rejected.

This is in line with research conducted by (Tibiletti et al., 2021; Nguyen et al., 2021; Nwude & Nwude, 2021) that more independent boards reduce the likelihood of companies publishing ESG reports. This reality reflects the fact that independent boards are more effective in protecting stakeholder interests regardless of ESG disclosure activities. Additionally, there is the idea that publishing a good ESG report requires considerable time and economic resources. The board of Independence may negatively impact ESG performance as independent directors may lack knowledge and expertise in ESG issues, which may result in a lack of oversight and accountability. Additionally, as financial performance is often the primary metric used to measure director performance. This can lead to a lack of attention and action on ESG issues, resulting in poor ESG performance.

Furthermore, ESG Performance has a coefficient value of 0.001 with a significance of <0.05, which means ESG Performance has a significant positive influence on financial performance. Thus, H3 is accepted.

First, companies with strong ESG performance have a good reputation, so they are attractive to stakeholders and can produce better financial results. Second, ESG performance can help reduce risks for companies, such as fines, public backlash, or business practices. Third, ESG-focused companies can innovate, create new products/services, and grow, resulting in better financial performance. Ultimately, effective ESG implementation will improve financial performance in the long term and be more likely to attract investors and customers. Extensive study of the ESG grading standards employed by top agencies has been published in earlier publications (Billio et al., 2021). Giese et al., (2019) show that disclosure of ESG information influences financial performance and evaluation.

ESG can serve as a bridge between other factors and the effect of independent directors on financial performance in the interim. The first, second, and third requirements are satisfied, as can be seen from the findings in the table above. As a result, H3 is justified because ESG can mitigate the impact of independent directors on financial performance.

The results of this research are in line with research of (Wedari et al., 2022; Ren et al., 2020; Nuskiya et al., 2021; Cek & Eyupoglu, 2020) that an independent board that pays attention to ESG can help build a strong company reputation and provide confidence to stakeholders that the company pays attention to social and environmental impacts and implements good governance practices. Higher trust can bring long-term benefits to a

company's financial performance. The ESG concept is important in driving business success. Independent Directors are critical to corporate governance and research shows that a strong governance structure results in better financial performance. ESG factors can improve financial performance by minimizing risks and enhancing brand reputation. Independent directors can improve ESG performance by monitoring and promoting it within the company and advocating to the executive team.

Table 5. Mediation Effect Test Results

Dependent	Independent	Coeff	Results
ESG	ID	-11,859***	Significant
F.P	ID	0.104***	Significant
F.P	ESG	0.001**	Significant
F.P	ID	0.117***	Significant
	ESG	0.001***	Significant

Source: Secondary data processed, 2023

Notes: FP = Financial performance, ESG = Environmental, social, and governance, ID = Independent directors. *, **, *** indicate significant at 0.1, 0.05 and 0.01 levels, respectively (2-tailed).

This research aligns with the legitimacy theory, which posits that the presence of independent boards that prioritize environmental, social, and governance (ESG) issues can motivate corporations to enhance their performance in terms of social and environmental responsibility, as well as good governance. This can provide social legitimacy and strengthen a company's relationships with stakeholders, including investors (Akhter et al., 2022).

Conclusion

This study looks into what effect independent directors have on how well a company does financially. The study also looks at how ESG scores affect the relationship between the three factors that are not dependent on each other. The test results show that Independent Directors have a big effect on how well a company does financially. So, as the number of Independent Boards rises, so does the success of the company. (2) The ESG factors are significantly harmed by independent directors. (3) The ESG mediation variable shows that ESG can help separate the role of Independent Directors from the company's financial success.

There are various constraints in this study that can impact the findings. The study focuses on two specific variables, namely ESG and independent director, as the determinants influencing financial performance, this is because the author has difficulty in getting access to Bloomberg data which limits data collection for more variables. However, it is important to note that there may be more factors that can also impact financial performance. Currently, the database does not provide enough information to conduct a more detailed study of the linkages between corporate ESG and Shariah perspectives. In Indonesia, which is a Muslim-majority country, there is a great opportunity to improve sharia services (Ridho & Ifada, 2023). Linking ESG disclosure with technology is also an option. Technology pervades almost every aspect of our lives in the twenty-first century (Ifada, et al., 2021).

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Appendix

Appendix 1. Number of sample companies by industry

Year	**Percent**	**Percent**
2013	39	**8.92%**
2014	40	**9.15%**
2015	56	**12.81%**
2016	55	**12.59%**
2017	68	**15.56%**
2018	73	**16.70%**
2019	73	**16.70%**
2020	33	**7.55%**
Total	437	**100.00%**
Industry	Freq.	**Percent**
Automobiles & Components	12	**2.75%**
Banks	62	**14.19%**
Capital Goods	37	**8.47%**
Consumer Durables & Apparel	6	**1.37%**
Energy	48	**10.98%**
Food & Staples Retailing	3	**0.69%**
Food, Beverage & Tobacco	53	**12.13%**
Health Care Equipment & Services	10	**2.29%**
Household & Personal Products	9	**2.06%**
Insurance	7	**1.60%**
Materials	73	**16.70%**
Media & Entertainment	3	**0.69%**
Pharmaceuticals, Biotechnology & Life.	22	**5.03%**
Real Estate	32	**7.32%**
Retailing	18	**4.12%**
Telecommunication Services	27	**6.18%**
Transportation	7	**1.60%**
Utilities	8	**1.83%**
Total	437	**100%**

Source: secondary data Processed, 2023