



The Role of Leverage in Moderating ESG Disclosure and Financial Slack on the Company's Financial Performance

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ABSTRACT

The purpose of this study is to determine the effect of ESG Disclosure and financial slack on the Company's financial performance by using leverage as a moderating variable. The emergence of issues related to the environment, social, and governance of company operations in Indonesia raises concern and responsibility to the community in the form of sustainability reporting. ESG disclosure provides a more complete picture of the sustainability aspects of company performance that supports regulatory reporting in Indonesia which provides an overview of how the company performs financially in a certain period.

This research uses a quantitative approach with an explanatory method. The sample of this study is a mining company listed on the IDX for the period 2020-2022. The sampling method used was purposive sampling, with a total sample size of 50 companies and a total observation data of 150. Data analysis using moderated regression analysis (MRA). The results showed that the financial slack variable had a significant effect on the company's financial performance and leverage was able to negatively moderate the influence of the financial slack variable on the company's financial performance. In contrast, ESG disclosure had no significant effect on the company's financial performance and leverage was unable to moderate the influence of the ESG disclosure variable on the company's financial performance.

KEYWORDS: Leverage, ESG Disclosure, Financial Slack, Corporate Financial Performance.

INTRODUCTION

Performance is an important factor in measuring the success of the business managed by the company because performance shows how well the company utilizes and manages its resources. An indicator of success in improving the performance of a company is the improvement of a company's financial performance, as evidenced by profit growth or the continued increase in sales of a company (Ningtyas & Aryani, 2020). Financial performance represents the financial health of a company and can be analyzed using financial analysis tools to determine how the company is performing over some time. Investors must know the company's financial condition, especially about the continuity of the company's operations (Wahyuni, Mahliza, et al., 2023). Is the company's condition good or bad? The financial performance achieved and generated by a company can be seen in the financial statements. Financial performance can be assessed using a financial ratio approach, such as profitability ratios which can be measured by Return on Assets (ROA).

Financial performance in various company sectors can increase or decrease. Mining sector companies are companies that contribute to the production of natural resources in the form of mining materials and minerals needed by many parties. As is known, issuers in the mining sector are experiencing a downward trend in 2023. Despite the decline in prices of global commodities, there are still many investors who are interested in owning them to seek medium-term profits (CNBC Indonesia, 2023). Coal companies are classified as cyclical stocks, which are stocks whose price developments follow economic developments. That is, its development is under the price of raw materials and global demand, which also develops by the global economy. Issuer owned by Garibaldi 'Boy' Thohir PT Adaro Energy Indonesia Tbk. (ADRO) recorded a net profit of US\$ 873.83 million or around Rp 13.89 trillion during the first semester of 2023. In addition, mining company ITMG recorded a net profit of US\$ 306.94 million in the first semester of 2023. This figure dropped 33.39% from the same period in 2022 which amounted to US\$



460.82 million. Meanwhile, ITMG's basic earnings per share was recorded at US\$ 0.27, from US\$ 0.41 in the same period in 2022.

In addition to problems related to coal sales and prices, mining companies also face problems related to environmental pollution due to waste disposal generated from company operations. Mining companies that carry out activities directly related to natural resources can cause environmental problems in the form of deterioration and degradation of environmental quality, such as soil, water, and air pollution due to global warming, natural exploitation, and industrial waste. The occurrence of environmental problems shows that company management has a huge impact on the environment and society. This makes many companies begin to show their concern and responsibility for environmental and social issues that occur by providing their responsibility to the community in the form of sustainability reporting.

Financial performance provides an overview of how a company is performing financially in a given period. It is an analysis used to assess how well a company complies with financial regulations, such as meeting the standards and provisions in SAK or IFRS (Aminah et al., 2023). This analysis serves as a tool to evaluate the financial position of a company using financial ratio analysis, which allows you to assess the company's performance in a certain period. The measure of financial performance used in this study is return on assets (ROA) which is one of the profitability ratios. Measurement using ROA is carried out to determine the effectiveness of a company in utilizing its assets to generate profits or profits. The higher the company's ROA, the greater the company's development potential. ROA helps management in making business decisions and is a benchmark for investors to evaluate before making investment decisions.

In line with the government's goal of implementing sustainability to improve economic welfare, companies are now applying ESG (Environment, Social, and Governance) principles that refer to the environmental, social, and governance impacts of companies and the decision to invest in them (P. S. Sari & Widiatmoko, 2023). Environmental, Social, Governance (ESG) is a corporate standard of investment practice that integrates and implements corporate policies in line with environmental, social, and governance concepts. As a form of concern, companies are required to present these activities in a report commonly referred to as environmental social governance disclosure which includes disclosures regarding corporate social performance, governance performance, and environmental performance (Wahyuni et al., 2024). Investors believe that there is a reciprocal relationship between the investment portfolio and the environment and social (P. S. Sari & Widiatmoko, 2023). Disclosure of ESG factors benefits companies and stakeholders. Sustainability reporting results in better decision-making, transparency, and continued financial stability. (Chen & Xie, 2022); (Alfalih, 2023) states that ESG disclosure has a significant effect on the Company's financial performance and can improve the company's financial performance can improve However, research conducted by (Putri & Puspawati, 2023); (Nisa et al., 2023); (Aminah et al., 2023)

states that ESG disclosure has no significant effect on financial performance.

Financial slack is a condition where the company's financial availability exceeds the company's own needs in financing the company's needs. Companies that experience financial slack can make them have additional resources that can be used as protection for the company. This research focuses on financial flexibility and whether financial flexibility provides value to the company. Financial flexibility is understood as excess financial resources, such as debt capacity and cash reserves, which also connotes financial slack (Odum et al., 2019). Financial slack can originate from management policies used to improve environmental sustainability and finance innovation or change and improve the company's response to environmental disturbances in the company (Pasaribu & Haryanto, 2018). Financial slack can be measured through several indicators, namely through the current ratio (ratio of total debt to equity) and the ratio of general and administrative expenses to sales (Odum et al., 2019). According to (Hailu et al., 2018) states that financial slack influences company performance.

In this study, leverage is used as a moderating variable because of the interest in providing empirical evidence of the effect of ESG disclosure and financial slack on the Company's financial performance if the Company's financial condition has net assets dominated by debt (high-level of debt).

Based on the description of previous research, it was found that there was inconsistency in the results of previous research so that in this study, the leverage variable was added as a moderating variable as a solution to the gap that occurred, which later was expected to be able to provide interactions to strengthen or weaken the influence of ESG disclosure and financial slack on the Company's financial performance. In this study, leverage is measured using the Long-Term Debt to Assets Ratio (LDAR). This ratio can show the amount of assets owned by the company whose value comes from long-term liabilities.

Our study has two main contributions. First, it investigates ESG disclosure and corporate financial performance, which contributes to the informal disclosure and corporate performance literature. This study provides recent empirical evidence regarding the development of environmental, social, and governance integration in emerging markets. Secondly, the addition of the leverage variable as a moderator to provide the interaction between ESG disclosure and financial slack on corporate financial performance and the measurement of leverage with the new LDAR proxy are used in this study. These contributions help close the gap and broaden the understanding of corporate sustainability disclosure practices, as well as provide theoretical insights into the relationship between ESG practices, financial slack, and corporate financial performance.

Literature Review

1. Grand Theory

According to legitimacy theory, an organization's operational practices in its external environment have the potential to influence and shape the company's compliance with



the social norms of the society in which it operates. Legitimacy theory states that organizations need to consider the behavior and decisions taken about their environment (Dowling & Pfeffer, 1975). Signal theory reveals that information or signals related to the company's condition are utilized by investors for decision-making (Dowling & Pfeffer, 1975). According to signal theory, external parties with an interest in enhancing the company's worth and reputation get information or signals based on the business's performance as well as the economic, ecological, and social situations (Wahyuni, Suprayogi, et al., 2023).

From the viewpoint of signaling theory and legitimacy theory, business organizations must be aware of the values and norms that apply in the community where the business operates to build legitimacy with the surrounding community and provide benefits to its stakeholders. This is important because society is used as a factor that affects the sustainability of the company. ESG disclosure can be used to explain company policies to see the company's reputation in improving company performance. An important goal of stakeholder theory and legitimacy theory is to help managers understand the stakeholder environment and effectively manage the relationship between the business environment (Sari & Widiatmoko, 2023).

2. Company financial performance

Company performance is an important indicator applied to measure the level of success achieved by the company (Antonius & Ida, 2023). Financial performance is a measure within a company to assess the level of success of a company's profits (Utami, 2023). Financial performance aims to assess how well the company complies with financial regulations and practices (Jan et al., 2021). Financial performance serves as a measure of the company's achievements in a period; positive financial performance attracts investor interest. Financial performance is a description of a company's financial condition in a certain period, both regarding aspects of raising funds and channeling funds which are usually measured by indicators of capital adequacy, profitability, and liquidity. The company's financial performance in this study is measured using return on assets (ROA).

3. ESG Disclosure

Sustainability reporting is a medium used by companies to disclose information about ESG implementation and performance. Sustainability reporting is a medium used by companies to disclose information about the company's ESG

implementation and performance (Wahyuni et al., 2024). ESG disclosure is a measurement tool in the development of information disclosure on the impact of environmental, social, and governance practices implemented by the company. The disclosure of this non-financial information can be used as an important indicator in assessing and evaluating the company's performance during the sustainability of its operational activities and their impact on these three criteria (Ghazali & Zulmaita, 2020). The measurement of ESG disclosure can be traced using the GRI Standards. In the ESG disclosure approach, companies can use GRI 300 for environmental topics with a total disclosure indicator of 32 items, GRI 400 for social topics with a total disclosure indicator of 40 items, and GRI 102 for governance information with a total disclosure indicator of 27 items. The ESG disclosure calculation technique can use the comparison of the number of indicators that a company has successfully reported with the total number of indicators in each GRI module for each ESG aspect. Financial Slack is a phenomenon where the availability of company finances exceeds their needs which are then used to help finance the organization (Puspitasari & Azib, 2019). Financial slack refers to the level of assets available to an organization (cash on hand) that can be easily placed or distributed by management for various uses or purposes. Financial slack can also be referred to as unabsorbed slack. Financial slack in this case will reduce capital restrictions and increase managers' strategic choices for investment, experimentation, and risk-taking that have positive performance implications.

4. Leverage

Leverage shows how a company uses assets and sources of funds that have fixed costs to increase shareholder returns (Revata & Sudirgo, 2023). Leverage is the debt used to finance assets that comes from creditors, not from investors or shareholders. This is called leverage (K. I. Sari & Wahyuni, 2023). Leverage can also be interpreted as a policy taken by a company to invest funds or develop financial resources in connection with the fixed costs that must be borne by the company. Leverage is a ratio that measures the company's ability to meet its long-term obligations. This ratio is usually used by investors to analyze a company and influence investment decisions. Leverage represents the ratio between the amount of capital owned by the company itself. The use of leverage aims to achieve greater profits than the cost of assets and funding sources (Aminah et al., 2023).

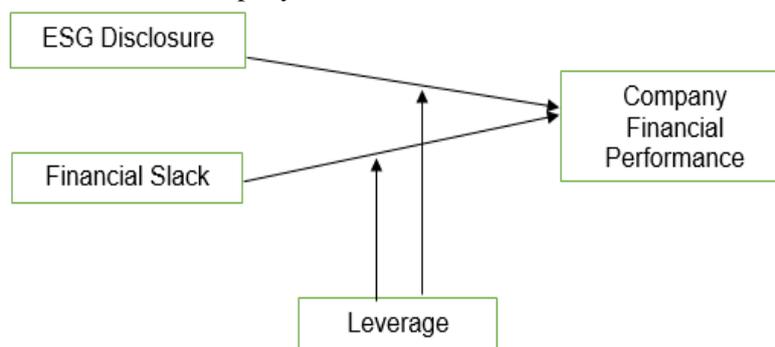


Figure 1. Research Framework



Hypothesis

H1 = ESG Disclosure Affects the Company's Financial Performance.

H2 = Financial Slack Affects the Company's Financial Performance

H3 = ESG Disclosure Affects Leverage-Moderated Company Financial Performance

H4 = Financial Slack Affects Leverage-Moderated Company Financial Performance

Methodology

Research Design

This research uses a quantitative approach. The method used in this research is the explanatory research method. This method explains the causal relationship between variables through hypothesis testing. The data source of this research uses secondary data derived from literature studies, Bloomberg sites, annual reports, and sustainability reporting at www.idx.co.id as well as through the company's website which is used as the object of research. In this study, the dependent variable is the company's financial performance proxied by ROA. The independent variable is ESG disclosure and financial slack and the moderating variable is leverage.

Population and Sample

The population that is the object of this research is companies that have been listed on the Indonesia Stock Exchange (IDX) from 2020 to 2022 consisting of the Healthcare sector, Basic materials, Transportation & Logistics, Technology, Consumer Non-Cyclicals, Industrials, Energy, Consumer Cyclicals, Infrastructures and Properties & Real Estate.

The sampling technique used in this study is purposive sampling, which is research based on certain considerations in sampling. So companies that are not by the criteria determined by the researcher will be excluded from the sample, the criteria used in sampling research are companies listed on Morningstar Sustainalytics on the IDX website, companies that have ESG Disclosure scores on the Bloomberg website, companies that do not experience losses, companies that publish financial reports and consecutive year reports during 2020-2022. Based on the sampling results that have been carried out, there are sample objects of 50 companies.

Variable Operationalization

Dependent Variable

Company Financial Performance

The Company's financial performance is measured using the Return on Asset (ROA) proxy. Return on Asset (ROA) is a profitability ratio that shows the company's effectiveness in utilizing assets for the company's overall operations in generating profits (Nisa et al., 2023). $ROA = \frac{\text{Net Income}}{\text{Total assets}} \times 100\%$

Independent Variable

ESG Disclosure

Independent variables in this study are variables that can influence environmental, social, and governance (ESG). Environmental, social, and corporate governance disclosure or

ESG disclosure is a variable that measures the non-financial performance of a company based on environmental, social, and governance aspects. Disclosure of non-financial information can be used as an important indicator to assess and evaluate the performance of a company's business operations and its impact on these three criteria. ESG disclosure is measured using the Bloomberg Score. The values range from 0 for companies that disclose the least amount of ESG data to 100 for the highest amount recorded in the Bloomberg database. Bloomberg ESG Score is the percentage of disclosures made by a company using Bloomberg's disclosure standards (Sari & Widiatmoko, 2023).

Financial Slack

Financial slack in this study is measured in the form of available slack, which is related to extra resources owned by a company so that managers become more flexible in carrying out their activities. For example, the availability of cash and securities is a form of available slack. Various empirical studies in finance use the current ratio as a proxy for available slack (Silalahi, 2015).

Moderating Variable

Leverage

Leverage is the extent to which a business uses fixed-cost resources and capital, including debt, to increase its profit potential. In this study, leverage is measured by LDAR (Long Term Debt to Asset Ratio) by dividing long-term debt by total assets (Prabowo et al., 2022).

Analysis Method

The regression model used in this study is MRA (Moderated Regression Analysis) or interaction test is a special application of multiple linear regression where the regression equation contains an element of interaction (multiplication of two or more independent variables). Before conducting the MRA test, descriptive statistical testing, normality test, classical assumption test (multicollinearity, heteroscedasticity, and autocorrelation) then linear regression test, and finally MRA (Moderated Regression Analysis) test are carried out. This test is conducted to see the significance of the individual influence of the independent variables in the model on the dependent variable. In this study, there are two forms of regression models, namely as follows:

$$\text{Model 1: } FP = \alpha + \beta_1 \text{ESGD} + \beta_2 \text{FS} + e$$

$$\text{Model 2: } FP = \alpha + \beta_1 \text{ESG} + \beta_2 \text{FS} + \beta_3 \text{ESG} * \text{Lev} + \beta_4 \text{FS} * \text{Lev} + e$$

Description:

FP= Financial Performance of the Company as measured by ROA (return on assets), which is the division between profit after tax and total assets.

ESGD= ESG disclosure score, the score is obtained from the Bloomberg database which assesses the ESG disclosure score including three elements contained therein, namely environmental disclosure, social disclosure, and governance disclosure elements in one numerical size ranging from 0 to 100

FS= Financial Slack as measured by the current ratio which is current assets divided by current liabilities (Odum et al., 2019)



Lev= Leverage as measured by LDAR (Long Term Debt to Asset Ratio) by dividing long-term debt by total assets (Prabowo et al., 2022)

Result and Discussion

Determination Coefficient Test

Table 1. Determination Coefficient Model Summary^b

Model	R	R Square	Adjusted Square	R
1	.414 ^a	.172	.159	

a. Predictors: (Constant), FinSlack, ESGD

b. Dependent Variable: ROA

In testing the coefficient of determination, the value seen only by 17.2%, the remaining 82.2% are other factors not is the R Square value and has a value of 0.172 or 17.2%. This examined in this study. means that the ESG Disclosure and Financial Slack variables can explain the Company's Financial Performance proxied by ROA

Model Fit Test (F Test)

Table 2. Model Fit Test ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	541.563	2	270.781	13.571	.000 ^b
	Residual	2613.783	131	19.953		
	Total	3155.346	133			

a. Dependent Variable: ROA

b. Predictors: (Constant), FinSlack, ESGD

The results of testing the suitability of the model or the F test, stating the sig value. $0.000 \leq 0.05$ means that the data model

in this study is suitable for examining the company's financial performance proxied by ROA.

Multiple Linear Regression Test

Table 3. Uji Hipotesis Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.392	2.105		.661	.510
	ESGD	.027	.039	.054	.673	.502
	FinSlack	1.726	.332	.420	5.207	.000

a. Dependent Variable: ROA

In model 1:

1. The regression coefficient value of the t-statistical test on the ESG Disclosure variable (X1) is 0.673 with a significance probability level of $0.502 > 0.05$ so it can be concluded that ESG Disclosure has no significant effect on the Company's financial performance.

2. The regression coefficient value of the t-statistical test on the ESG Disclosure variable (X2) is 5,207 with a significance probability level of $0.000 < 0.05$ so it can be concluded that financial slack has a significant effect on the company's financial performance.

MRA Test (Moderated Regression Analysis)

Table 4. Coefficient of Determination MRA Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.475 ^a	.225	.195	4.36959	1.282

a. Predictors: (Constant), X2M, ESGD, FinSlack, X1M, Leverage

b. Dependent Variable: ROA



Based on the results of MRA testing on the coefficient of determination, the R Square value is 0.225, which means that the contribution of the influence of ESG Disclosure and Financial Slack on the Company's Financial Performance after the moderating variable (leverage) is 22.5%.

The regression test for the moderating variable (leverage) in this study applies the interaction test method or

what is known as the MRA (Moderated Regression Analysis) test. In this model, there is an element of interaction between two or more variables between the independent variables (ESG Disclosure and Financial Slack) and the moderating variable (leverage). In this study, the results of the MRA equation test can be seen in the following table:

Table 5. MRA Test Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error			
1	(Constant)	-1.627	3.165		-.514	.608
	ESGD	.089	.060	.182	1.494	.138
	FinSlack	2.235	.464	.543	4.816	.000
	Leverage	18.726	11.844	.583	1.581	.116
	X1M	-.351	.247	-.506	-1.421	.158
	X2M	-4.650	2.089	-.279	-2.226	.028

In model 2:

1. The regression coefficient value of the t-statistical test on the ESG Disclosure variable (X1) is 1.494 with a significance probability level of 0.138 > 0.05 so it can be concluded that ESG Disclosure has no significant effect on the company's financial performance and the first hypothesis is rejected.
2. The regression coefficient value of the t-statistical test on the financial slack variable (X2) is 4.816 with a significance probability level of 0.000 < 0.05 so it can be concluded that financial slack has a significant effect on the Company's financial performance with a positive relationship direction and the second hypothesis is accepted.
3. The regression coefficient value of the t-statistical test on the leverage variable moderating ESG Disclosure (X1M) is -1.421 with a significance probability level of 0.158 > 0.05 so it can be concluded that leverage cannot moderate the effect of ESG disclosure on the company's financial performance so that the third hypothesis is rejected.
4. The regression coefficient value of the t-statistical test on the leverage variable moderating financial slack (X2M) is -2.226 with a significance probability level of 0.028 < 0.05 so it can be concluded that leverage can moderate the effect of financial slack on the company's financial performance with the interaction weakening the relationship so that the fourth hypothesis is accepted.

Discussion

The Effect of ESG Disclosure on Company Financial Performance

Currently, the disclosure of non-financial factors such as ESG disclosure indicators by companies has the aim of providing additional information about the company's financial performance that has not been raised in the annual report data or financial statements. ESG disclosure is a disclosure of company

performance using ESG principles, namely Environment, Social, and Governance in its implementation, it is expected that the company meets the standards of good corporate governance by holding GCG principles in its operations, namely people, planet, and profit. Through the sustainability report, stakeholders are interested in understanding how the company's sustainable approach and performance in various aspects, especially economic, environmental, and social aspects including the potential for value creation and improving the company's financial performance (Indriawati et al., 2021). ESG disclosure increases the return on investment achieved by the company. ESG disclosure will provide an increase in public trust in the company by stakeholder theory. However, based on the test results, shows that ESG disclosure does not significantly affect the company's financial performance. The size of the ESG disclosure score does not affect the company's financial performance because it has not become a mandatory policy in its preparation so that it is only a mere regulation carried out by the company. These results are in line with research conducted by Nisa et al.(2023) which states that ESG disclosure does not influence the Company's financial performance.

The Effect of Financial Slack on Company Financial Performance

Financial slack can be defined as the amount of slack from cash. The leeway of available resources, especially finance, usually consists of excess reserves that are not absorbed and make it a very important innovation resource. Yoo et al,(2021) show that financial slack has a positive effect on company performance. This is due to frequent changes in laws, and economic policies. Companies with financial availability can apply the resources provided by this slack to gain external knowledge and opportunities to improve company performance. Firms use internal sources of funds to implement new and profitable projects. The theory suggests that internal financing is the main source of financing innovative projects under asymmetric information conditions so that firms are reluctant to



use external sources of funds in financing new projects because external financing causes adverse selection problems in the capital market so that internal financing becomes cheaper than external financing. Therefore, innovative activities are more appropriately financed through internal financial slack activities.

Leverage Moderates the Effect of ESG Disclosure on Company Financial Performance

The existence of leverage interaction in influencing ESG disclosure on the company's financial performance. The lack of effect of ESG on leverage is possible because ESG disclosure is not used as a determinant for company managers to determine company funding. The deduction of debt interest on taxable income reduces the proportion of tax expense so that net profit after tax becomes greater and profitability also increases. However, the results prove that ESG does not affect leverage, where ESG does not determine funding through debt. So this results in leverage that is not influenced by ESG and does not affect the company's financial performance.

Leverage Moderates the Effect of Financial Slack on Company Financial Performance

Financial slack is defined as excess liquid resources, which have not been used to carry out certain organizational functions. Success in improving performance depends on the ability to combine domestic resources. So, one of the relevant resources to increase the organization's capacity to generate new opportunities is the availability of financial slack. Companies with fewer resources about their operational demands tend to be more efficient as they find ways to increase and expand their available resources.

Conclusion

We examine the relationship between ESG disclosure and the financial performance of companies listed on the Indonesian stock exchange from 2020 to 2022. To avoid the influence of errors in the measurement of ESG scores, we use the ESG rankings of companies first published by Bloomberg as

shocks. Based on the research results in testing the relationship between the independent variable and the dependent variable with moderation, the answers to the research hypotheses can be found. The results found that ESG disclosure has no significant effect on the company's financial performance while financial slack has a significant positive effect on the company's financial performance and leverage cannot moderate the relationship between ESG disclosure and the company's financial performance, but leverage as moderation can weaken the relationship between financial slack and the company's financial performance.

The research found that market participants, including companies, investors, and regulators, can better understand the influence of ESG information transparency on business and societal growth. In addition, this article discusses the following rules that standard-setters can use to promote the development of harmonized governance, society, and environment. First, companies should assume greater ESG responsibilities and actively disclose non-financial information to achieve coordinated economic and environmental development. We found that disclosure of ESG information not only leads to increased costs; greater transparency will attract investors and may improve financial performance in the long run. CSR reports and annual reports reveal most of the ESG behavior of companies; however, these two reports are not enough to show the behavior of companies.

At present, ESG scores cannot be used to study corporate behavior due to the difference between ESG evaluation indicators and weights. To encourage companies to adopt uniform environmental information disclosure standards, policymakers should establish standardized ESG disclosure formats and regulatory requirements. Companies can only communicate with their stakeholders in this way.

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