The Effect of Environmental Performance and Agency Cost on Financial Performance

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ABSTRACT

This study examines the impact of environmental performance and agency cost on financial performance. The population of this study consists of manufacturing companies listed on the Indonesian Stock Exchange (BEI) from 2018 to 2022. A total of 162 observations from 27 companies were obtained using purposive sampling. The study employs a quantitative approach and uses panel data regression analysis with E-Views 10 software. The results show that environmental performance and agency cost have a simultaneous impact on financial performance. However, environmental performance does not have a significant impact on financial performance, while agency cost does. The study recommends that companies pay attention to agency cost to maintain their financial performance.

***Keywords**: Kinerja Lingkungan; Agency Cost; Kinerja Keuangan; Regresi Data Panel*

ABSTRAK

Penelitian ini mengkaji pengaruh kinerja lingkungan dan biaya agensi terhadap kinerja keuangan. Populasi penelitian ini adalah perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia (BEI) dari tahun 2018 hingga 2022. Sebanyak 162 data observasi dari 27 perusahaan diperoleh menggunakan metode purposive sampling. Penelitian ini menggunakan pendekatan kuantitatif dan analisis regresi data panel dengan software E-Views 10. Hasil penelitian menunjukkan bahwa kinerja lingkungan dan biaya agensi berpengaruh secara simultan terhadap kinerja keuangan. Namun, kinerja lingkungan tidak berpengaruh signifikan terhadap kinerja keuangan, sedangkan biaya agensi berpengaruh. Penelitian ini merekomendasikan agar perusahaan memperhatikan biaya agensi untuk menjaga kinerja keuangan.

***Kata kunci**: Kinerja Lingkungan; Biaya Agensi; Kinerja Keuangan; Regresi Data Panel*

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INTRODUCTION

The company's financial report is a source of financial condition information needed by external parties to assess the company's performance. Profit information in the financial report is used as a benchmark for the company's financial performance. Company management must strive to improve competitive advantage through planning accuracy and identifying needs. Increasing competitive advantage can be achieved in several ways, namely planning accuracy, identifying needs by considering various environmental conditions that are always changing, and planning maturity which are important factors and are related to the level of the company's financial performance in the future. Profitability ratios can be used as indicators of the company's financial performance. Financial performance information is useful for predicting the company's capacity to generate cash flow and assessing the company's effectiveness in utilizing additional resources. The manufacturing industry, which plays a major role in the Indonesian economy, showed a decline in growth in 2019. The manufacturing industry in the fourth quarter of 2019 grew 3.66% lower than the fourth quarter of 2018 which only grew 4.25%.

The manufacturing industry throughout 2019 also declined when compared to 2018, which grew 3.8% down 12.4% when compared to manufacturing growth in 2018 which was 4.3%. This needs to be considered because it has a major impact on the Indonesian economy. Investors will be interested in investing their capital if the company's financial performance is good. However, companies do not only generate the highest possible profits, but must also consider environmental factors in their operational activities. Company activities can have an impact on the environment, so companies are expected to think about or consider the social impacts caused by company activities and efforts to overcome them (Sigalingging, 2019; Sianturi, 2020). Environmental problems are increasingly becoming a concern for both the government, investors, and consumers. Industrial conflicts such as environmental damage due to excessive exploitation of nature, damage to the balance of nature and the environment, and factory waste or pollution are very detrimental to the surrounding environment (Shah, 2021; Sridini, 2022). Therefore, companies must pay attention to the principles of environmental management and increase the level of environmental performance and interest in environmental conservation. Environmental damage due to company operational activities can cause the company to lose social legitimacy and bear the cost of environmental repairs and social costs that erode the company's profitability (UY & Hendrawati, 2020; Lestari & Kusuma, 2022). Therefore, companies must improve the company's financial performance by participating in environmental performance programs as the company's responsibility to the environment.

Attention to environmental issues currently raises pros and cons for most business organizations. Companies must understand that attention to environmental awareness is already a mandate or obligation. Lack of attention to the environment can cause serious problems and loss of public trust. Therefore, companies must carry out their activities based on applicable norms and regulations and maintain agreements with the community. Manufacturing sector industrial companies have a major role as causes of environmental pollution (Syairozi, 2019). Many companies have been subject to administrative sanctions for polluting the environment. Compliance in the manufacturing sector in environmental management is still low, with only 23 companies in the green category and one company in the gold category. In Indonesia, the basics of environmental policy began with the enactment of the Environmental Law in 1982. The accounting treatment of environmental impacts is also regulated in the Statement of Financial Accounting Standards (PSAK). To assess the environmental performance of companies, the government formed the Company Performance Rating Program in Environmental Management (PROPER). Improving the company's financial performance can be achieved through cooperation between company management and other parties (Alim & Assyifa, 2019; Laksono, 2021). However, the existence of an agency problem can result in the company's financial goals not being achieved. Therefore, the company must bear agency costs to resolve this agency problem.

Agency costs incurred by the principal to monitor management performance can reduce the profits generated and result in a decline in the Company's financial performance (Imelda, 2019). Therefore, the existence of this agency problem must be minimized with various strategies so that the company's financial performance is high. Previous research by Suaidah & Putri (2020) and Kinasih et al. (2022), shows that environmental performance and CSR disclosure can affect the company's financial performance. However, the results of the study also show that agency costs do not always affect company performance. Therefore, further research is needed to understand the relationship between agency costs and company financial performance. Research conducted by Muhibbai & Basri (2017), shows that agency costs and intellectual capital have a positive and significant effect on the financial performance of Islamic banking. However, research according to Mudiansyah et al. (2020), states that agency costs do not affect company performance in manufacturing companies listed on the IDX.

LITERATURE REVIEW

According to agency theory, there is a conflict of interest between shareholders and company managers. This conflict can cause managers to make suboptimal decisions and sacrifice the interests of shareholders. However, by carrying out Corporate Social Responsibility (CSR) activities, companies can reduce the potential for agency problems and improve company performance, thereby reducing agency costs (Liu et al., 2016). Signal theory explains the procedures for companies in providing information to users of financial statements. If the company's profits decrease, this will be a signal that the company's performance is deteriorating, conversely if the company's profits increase, it will be a signal that the company's performance is improving. The information disclosed by the company is very important, because this information will later be used as a consideration for decisions for investment by parties outside the company (Wardani & Susilowati, 2020). Setyaningsih & Asyik (2016), stated that in providing an overview of a company's financial position, it can be seen from the company's financial performance as measured by financial reports issued periodically. The measure of a company's financial performance is usually manifested in profitability, growth and shareholder value. Financial performance in this study was measured using ROE (Return on Equity).

According to Septiani et al. (2019), environmental performance is the company's performance in creating a good or green environment. In Indonesia, the implementation of corporate environmental performance is facilitated by PROPER, which is managed by the Ministry of Environment. The PROPER performance rating system consists of five color categories that represent a company’s compliance with environmental standards. The highest category is Gold, indicating excellent performance with a score of 5. Below that, the green category signifies very good performance with a score of 4, while Blue denotes good performance with a score of 3. Red indicates poor performance with a score of 2, and the lowest category, Black, reflects very poor performance with a score of 1. This system provides a clear framework for evaluating the level of environmental compliance of companies. Agency cost is the cost incurred by the principal to the agent, both in supervision, binding expenses and losses (Jensen and Meckling, 1976). Agency cost in this study is calculated using the operating expenses ratio.

When stakeholders seek to control organizational resources, they are oriented towards improving their welfare. To achieve this, the costs incurred by the principal to pay agents can spur management performance and improve the company's financial performance. The results of Muhibbai & Basri's (2017) research also show that agency costs have a positive and significant effect on financial performance. Environmental problems arising from the company's operational activities in the form of environmental damage, encourage the emergence of environmental accounting practices as a tool for public accountability for the company's efforts (Haholongan, 2016). The greater the company's role in environmental activities, the better the company's image for stakeholders. In line with the results of research conducted by Djuitaningsih & Ristiawati (2015) and Angelia & Suryaningsih (2015), that environmental performance has a positive and significant effect on the company's financial performance. The costs incurred by the principal to pay agents can spur management performance and improve the company's financial performance. This is in line with the research of Muhibbai & Basri (2017), which shows that agency costs have a positive and significant effect on financial performance. The conceptual framework in this study consists of a dependent variable of financial performance (Y) and two independent variables, namely environmental performance (X1) and agency costs (X2) as described below:

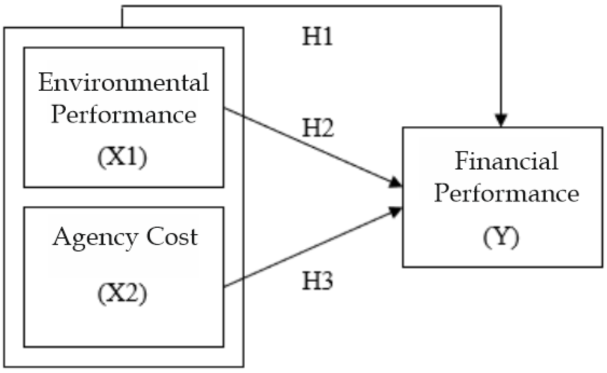

Figure 1. Conceptual Framework

H1: Environmental performance and agency costs are suspected to have an effect on financial performance
H2: Environmental performance is suspected to have an effect on financial performance
H3: Agency costs are suspected to have an effect on financial performance

METHODS

This study uses an associative quantitative approach, with the aim of analyzing the relationship between variables in manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the 2015-2020 period. The type of data used is panel data (pooled data), which combines time series and cross-section data, allowing for a more in-depth analysis of changes and relationships between variables between companies over a certain period of time. The data collected is secondary data, in the form of annual reports from each company that is the object of the study. The population in this study includes all manufacturing companies listed on the IDX in the 2015-2020 period, with a total of 196 companies. However, the research sample was taken using a nonprobability sampling technique, more specifically the purposive sampling method, namely the selection of samples based on certain criteria that are relevant to the research objectives. After the sample selection process was carried out, only 27 companies met the research criteria. The data obtained were analyzed using the Econometric Views (EViews) program, which is commonly used for panel data analysis. This technique allows researchers to identify relationships between variables that may affect firm performance, as well as understand patterns and trends that emerge in panel data spanning multiple years.

RESULTS

The results of the descriptive statistical test that have been processed using EViews 10 obtained financial performance variables are measured using ROE, which measures the company's profit per rupiah of shareholder capital. The ROE value at Voksel Electic Tbk in 2015 ranged from 0.000544 and at Unilever Indonesia Tbk in 2020 ranged from 1.450882, with an average of 0.217013, meaning that every Rp1.00 of share capital generates a net profit of Rp0.217013. Environmental performance variables are measured using PROPER, with an average value of 3.092593, indicating good environmental performance (blue category). PROPER values range from 2 (companies with poor environmental performance) to 4 (companies with very good environmental performance), with several examples of companies that have extreme values. The agency cost variable of Wilmar Cahaya Indonesia Tbk in 2016 had an average value of 0.158069, with a range of values between 0.027969 and in Akasha Wira International Tbk in 2017 with a value of 0.456271. The average operating expenses ratio was 15.80%, indicating that some sample companies had low operating costs in marketing their products. Panel data regression can be done with three analysis models, namely common, fixed, and random effects, each of which has advantages and disadvantages. Here are the results of the three existing models:

Table 1. Panel Data Regression Results Common, Fixed and Random Effects

Model	Variable	Coefficient	Std. Error	t-Statistic	Prob.
Common Effect Model (CEM)	C	-0.146204	0.157088	-0.930716	0.3534
	Environmental Performance	0.093152	0.050444	1.846630	0.0667
	Agency Cost	0.475338	0.210192	2.261442	0.0251
Fixed Effect Model (FEM)	C	0.281254	0.080497	3.493977	0.0006
	Environmental Performance	0.013516	0.022305	0.605971	0.5456
	Agency Cost	-0.670852	0.223638	-2.999725	0.0032
Random Effect Model (REM)	C	0.233316	0.094233	2.475944	0.0143
	Environmental Performance	0.018752	0.022104	0.848363	0.3975
	Agency Cost	-0.470019	0.205793	-2.283937	0.0237

In panel data, model selection test is conducted to determine the more appropriate estimation model. Chow test is used to choose between common effect model and fixed effect model. If chi-square probability <0.05, then fixed effect model is selected, and if >0.05, then common effect model is selected. If fixed effect model is selected, then Hausman test is conducted to determine whether fixed effect model or random effect model is more appropriate to use. The test result shows that chi-square probability of 0.0000 is lower than 0.05, so fixed effect model is more appropriate to use. However, Hausman test is needed to ensure the suitability of the model. Hausman test result shows that fixed effect model is more appropriate to use because chi-square probability value is 0.0496 <0.05. Therefore, fixed effect model is selected as the model used in this study. The multicollinearity test is used to determine whether the independent variables in the regression model have a high correlation. According to Gujarati & Porter (2013), if the correlation coefficient > 0.80, then the model experiences multicollinearity, and if < 0.80, then the model is free from this problem.

Table 2. Multicollinearity Test Result

Variable	Environmental Performance	Agency Cost
Environmental Performance	1.000000	0.120935
Agency Cost	0.120935	1.000000

The table above shows that there is no correlation between the independent variables that exceeds 0.80, so this regression model is free from multicollinearity problems. The heteroscedasticity test tests whether the residual variances in the regression model are the same or different. A good regression model does not have heteroscedasticity. The Wald test is used to detect heteroscedasticity, with the following criteria: if the probability is > 0.05, then there is no heteroscedasticity, and if < 0.05, then there is heteroscedasticity. The panel data equation model is a combination of time series and cross section data.

Table 3. Heteroscedasticity Test and Panel Data Regression

Test	Variable	Coefficient	Std. Error	t-Statistic	Prob.
Heteroskedasticities testing	C	0.220109	0.119970	1.834705	0.0688
	Environmental Performance	0.090071	0.066128	1.362084	0.1755
	Agency Cost	0.075936	0.046219	1.642967	0.1028
	C	0.281254	0.080497	3.493977	0.0006

Regression Data Panel	Environmental Performance	0.013516	0.022305	0.605971	0.5456
	Agency Cost	-0.670852	0.223638	-2.999725	0.0032

The results of the heteroscedasticity test in the table above show that all probability values of independent variables are > 0.05, so this model is free from heteroscedasticity. The panel data regression equation obtained Constant 0.281254 has a positive effect on financial performance. The environmental performance regression coefficient of 0.013516 shows a positive effect on financial performance. The agency cost regression coefficient of -0.670852 shows a negative effect on financial performance.

The F-statistic test is used to determine the effect of independent variables simultaneously on the dependent variable. The t-statistic test is used to test the effect of independent variables partially on the dependent variable, with the following criteria: probability value <0.05 has an effect, and >0.05 has no effect. The coefficient of determination (R2) test is used to determine the percentage of independent variables that can explain the dependent variable. The R2 value ranges between 0 and 1, where R2 = 1: The independent variable provides the information needed to predict the dependent variable and R2 = 0: The independent variable is unable to explain its effect on the dependent variable.

Table 4. Hypothesis Testing

Hypothesis Test	Variable	Coefficient	Std. Error	t-Statistic	Prob.
Simultaneous (F-Statistic Test)	C	0.281254	0.080497	3.493977	0.0006
	Environmental Performance	0.013516	0.022305	0.605971	0.5456
	Agency Cost	-0.670852	0.223638	-2.999725	0.0032
Partial (t-Statistic Test)	C	0.281254	0.080497	3.493977	0.0006
	Environmental Performance	0.013516	0.022305	0.605971	0.5456
	Agency Cost	-0.670852	0.223638	-2.999725	0.0032
Coefficient of Determination (R^2)	C	0.281254	0.080497	3.493977	0.0006
	Environmental Performance	0.013516	0.022305	0.605971	0.5456
	Agency Cost	-0.670852	0.223638	-2.999725	0.0032

The calculated F value is 51.57318 with a probability value of 0.000000 lower than α 0.05. So environmental performance and agency costs have a significant effect simultaneously on financial performance. From the Partial test (t-statistic test), Hypothesis H2 is obtained: Environmental performance does not affect financial performance (probability = 0.5456 > 0.05, t-Statistic = 0.605971), so it is rejected. Hypothesis H3: Agency costs have a negative effect on financial performance (probability = 0.0032 < 0.05, t-Statistic = -2.999725), so it is accepted. The Adjusted R-squared value of 0.897911 indicates that the independent variables (environmental performance and agency costs) explain 89.79% of the variation in financial performance variables, while the remaining 10.21% is influenced by other variables not measured in this regression model.

The Effect of Environmental Performance and Agency Cost on Financial Performance**.** The first hypothesis (H1) was tested using panel data regression, showing that environmental performance and agency costs together have a significant effect on financial performance. The Effect of Environmental Performance on Financial Performance**.** The results of the second hypothesis test (H2) show that environmental performance does not affect financial performance. This is not in accordance with the hypothesis, but is in line with research by Rosyid (2015) and Septiani et al. (2019). The possible cause is because Indonesian people do not yet consider the importance of environmentally friendly products, as well as environmental conservation costs that can reduce company profits. The difference in research results with previous studies may be due to the object of research, year of research, and ratio used. The Effect of Agency Cost on Financial Performance**.** The results of the third hypothesis test (H3) show that agency costs affect financial performance. This is consistent with research by Lutfia et al. (2019), Fu'adah (2013), and Komarudin & Affandi (2020). High agency costs can reduce a company's financial performance because management does not care about operational costs, so the company is inefficient in controlling its operational costs.

CONCLUSION

Conclusions based on the results of testing and data analysis, it can be concluded that environmental performance and agency costs together have a significant effect on financial performance in manufacturing companies. However, environmental performance does not affect financial performance, so companies that receive a PROPER rating do not necessarily provide benefits to investors. On the other hand, agency costs affect financial performance, because burdens affect the company's financial performance. Therefore, companies that are inefficient in controlling their operational costs will cause the company's profits to decrease. This study has been attempted and implemented in accordance with scientific procedures, but has limitations. These limitations include only two variables studied, namely environmental performance and agency costs, as well as the lack of a wide research sample which causes the possibility of data that has not been fully taken. Based on the results of the study, several suggestions can be given. For companies, it is important to consider current financial performance, especially environmental performance and agency costs, to see future prospects. For investors, the results of this study can be used as a consideration in investing. For further research, it is recommended to expand the sample and add other variables that affect the company's financial performance.

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