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# SUSTAINABLE SUCCESS: HOW ENVIRONMENTAL PERFORMANCE DRIVES PROFITABILITY: A CASE STUDY IN SRI-KEHATI COMPANIES

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**Abstract**

***The background*** *of this research is based on the importance of environmental performance in improving the Company's image and seemingly towards sustainable profitability. This study aims to determine the influence of environmental performance on company profitability. This study uses a quantitative method with secondary data from the Company's financial statements. The data collection technique is carried out through documentation analysis, while the data analysis uses panel data analysis using E-Views. The population in this study consists of all companies listed in the SRI-Kehati Index, as many as 25 companies with a saturated sampling method that produces 75 observations. The results of the study show that partially, Environmental performance, ISO 14001 Certificate, and Environmental Cost have a positive and significant influence on the profitability of the Company. The conclusion of this study is to provide insight for managers and stakeholders about the importance of environmental performance in achieving the Company's financial performance.*

***Keywords: Financial Performance, Environmental Performance, Environmental Disclosure, ISO 14001, Environmental Costs***

## Introduction

Financial performance is an assessment of a company that can include the Company's ability to maintain liquidity, solvency, and profitability. Many previous studies have explored the relationship between ESG and corporate financial performance by focusing on the social and environmental aspects of the Company and ignoring corporate governance factors (Ahmad et al., 2021). The assessment of a company's financial performance is based on the level of profitability expressed in the profit or profit earned by the Company. The profitability proxied by the ROA and ROE variables significantly affects the Company's value; however, the liquidity variable does not affect the Company's value (Santosa et al., 2020). Financial performance is usually evaluated using profitability, capital adequacy, and liquidity indicators. Financial performance can explain the Company's results in various activities carried out.

As a result, financial performance can be considered an analysis of how effectively and accurately the Company has implemented financial principles (Fatmawatie & Endri, 2022; Mandagie et al., 2024). In recent years, there has been a significant change in the pattern for companies in maintaining the sustainability of the Company, if; in the past, companies competed with each other to get the maximum profit regardless of the environmental and social impacts produced, but now companies are not only thinking about the economic aspect in the form of profits, companies are starting to think about the environmental and social impacts produced by their businesses. Researchers pay close attention to environmental sustainability orientation (ESO), which helps improve organizational performance (Amankwah-Amoah et al., 2019; Rehman et al., 2022).

Furthermore, environmental sustainability in reducing pollution requires actions and processes, renewable resources, using harmful resources, and eradicating all processes that affect the environment. The researchers emphasized that when environmental policies are adequately and correctly prepared, business competitiveness will continue to increase (Bresciani et al., 2021;

Rodríguez-Espíndola et al., 2022). The Financial Services Authority (OJK) assesses that the pandemic has increased awareness of the importance of environmental, social, and governance (ESG) aspects, so sustainable investment has become more in demand. Therefore, corporate sustainability has developed rapidly into one of the core social factors that can affect the ability to compete between companies and organizations. Investments in sustainable development and social responsibility make it an attractive concern for the world because environmental, social, and governance (ESG) can measure the three most essential sustainability factors and ethical impact on business investments (Zheng et al., 2022). As a result of the new challenges that are currently arising from social and ethical issues, the Company now faces much pressure, especially external pressure, because the information disclosed about the sustainability of performance in the ESG aspect directly affects the financing and corporate value (Zheng et al., 2022).

However, achieving a high level of company profitability is a responsibility of the Company, and the Company's profitability level may decrease. The decline that also occurs in the Company in the form of economic decline and the occurrence of structural crises can have a significant impact on profitability. For example, it can occur in the decline in the value of labor that occurred over some time (2013-2014) and the period during the Covid-19 period (2021-2022) that contributed to changes in the level of profitability in Cyprus (Kosmas & Ioakimoglou, 2023). Internal or external factors of the Company can cause this decline. One of the external factors that can affect the Company is the global economic condition or the economic condition of the country where the Company is located. One of the internal factors that can affect profitability is environmental performance. One of the things that is related to the environment and comes from the outside is environmental regulation. Environmental regulations can hurt a company's revenue and profits, especially when a company is unable to charge consumers an increased cost due to the high elasticity of market demand (Wang et al., 2021).

In addition, Indonesia's economic condition in 2020 experienced an economic decline influenced by the COVID-19 pandemic, which was able to weaken and destroy all economic sectors. There are regulations restricting activities. The Covid-19 pandemic around the world has triggered an extraordinary economic crisis. The current wave of the COVID-19 epidemic has had a devastating impact on the health and income of the world economy (Khan et al., 2022). The COVID-19 pandemic limits its impact on deteriorating human health while its adverse effects on economic and financial activities (Khan et al., 2022). So, the COVID-19 pandemic has impacted the Company's profit acquisition, which has decreased so that it can reduce the Company's performance and aspects of environmental performance that can affect the Company's profit acquisition.

This research is essential because, based on the 3P concept, companies are responsible to their shareholders or investors and help solve environmental and social issues. Companies that want to survive in their industry must consider the 3P principles: profit, people, and planet. When viewed from the perspective of people and the planet, it is significantly related to the environmental aspect, which is essential to pay attention to. Environmental aspects, including environmental disclosure, are an important part of the Company's efforts to address social and environmental issues actively. The aspects disclosed in the CSR report include economic, social, and environmental aspects. In carrying out its business activities, the Company must pay attention to environmental sustainability with ISO 14001, an international standard for Environmental Management Systems (SML) issued by the International Organization for Standardization (ISO).

Furthermore, to manage the environment appropriately and minimize the impact caused by the Company, it must consider other environmental perspectives, namely environmental costs or the allocation of costs incurred by the Company in environmental conservation activities. Good environmental management will give rise to the image of a company that cares about the environment in the eyes of the public and investors. Some of the actions taken by the Company in environmental management include making environmental disclosures based on GRI standards, implementing ISO 14001, and budgeting environmental costs. This research aims to explore how environmental performance affects company profitability. Environmental management through environmental disclosure, ISO 14001, and environmental cost allocation can improve company performance during the COVID-19 pandemic.

## Research Method

This study uses quantitative research; the population is 25 companies with a saturated sample, all listed in the SRI KEHATI Index. Data collection in this study uses documentation techniques. Data analysis uses E-views software, with panel data used.

## Results and Discussion

The study results show that partially environmental performance, ISO 14001, and environmental costs positively and significantly affect the Company's profitability.

**Table 1 Partial Test Results (*t-test*)**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| C | 0.678010 | 0.018668 | 36.31892 | 0.0000 |
| PL | 0.057993 | 0.021022 | 2.758612 | 0.0082 |
| ISO | 0.021463 | 0.006499 | 3.302566 | 0.0018 |
| BL | 0.001876 | 0.000649 | 2.892242 | 0.0058 |
| R-square | 0.715850 | Mean dependent var | 0.736800 | |
| Sum squared resid | 0.825977 | Durbin-Watson stat | 2.633708 | |

Source: (Data Processed 2024)

**Table.2 Results of Fixed Effect Model (FEM) Panel Data Regression Test**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| C | 0.678010 | 0.018668 | 36.31892 | 0.0000 |
| PL | 0.057993 | 0.021022 | 2.758612 | 0.0082 |
| ISO | 0.021463 | 0.006499 | 3.302566 | 0.0018 |
| BL | 0.001876 | 0.000649 | 2.892242 | 0.0058 |

Source: (Data Processed 2024)

## Conclusion

Environmental Disclosure variables, ISO 14001, and Environmental Costs partially influence profitability in Sri-Kehati Indexed Companies for the 2020-2022 period. Impact The environmental disclosure aspect, ISO 14001, and environmental costs make companies more active in disclosing information about sustainable and environmentally friendly business practices, which tend to lead to better financial performance. Environmental disclosures can include information on green practices, waste management, energy efficiency, and sustainable commitments that can support stakeholder trust and increase company value. Environment-related reports refer to any disclosure of financial and non-financial information made by the Company regarding the social and environmental impact of the Company's business and is still predominantly a voluntary activity carried out (Akhter et al., 2023). Strengthens its relevance to the Company for financial performance.

Implementing environmental disclosure has become essential in improving development efforts to ensure environmental protection. The rapid increase of industries and enterprises in our country has helped to improve economic development, but at the same time, it has also given rise to environmental problems, and these problems have led to the conception of natural well-being in danger, such as global warming, pollution of water, air, and soil (Akhter et al., 2023). In addition, many organizations have set environmental goals and assessed their contribution to environmental sustainability and management as one of the criteria in the performance evaluation program. ISO 14001 has established environmental standards, which is generally true with ISO 14001 accredited organizations (Malik et al., 2021). In addition, path-dependent learning, as exemplified in ISO 14001 and EMS, is an essential aspect of dynamic capabilities (Scarpellini et al., 2020). Environmental costs are also a significant factor that companies must consider when maintaining their financial stability. Various studies show a positive relationship between environmental costs and financial performance. For example, research on two significant plastics manufacturing companies shows that increased spending on environmental costs positively affects their financial performance and sustainability (Pickle et al., 2021).

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