Published online on the journal's web page: http://jurnal.usahid.ac.id/index.php/jamr

eISSN: 2797-2917

**Journal of Applied Management Research**

# Does the Sustainability Report Influence Financial Performance in Indonesian Energy Companies?

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ARTICLE INFO

Received: 12 October 2023
Revised: 10 November 2023
Accepted: 29 Desember 2023

*Keywords:*

*Sustainability Report, Financial Performance, Energy Sector*

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ABSTRACT

This study empirically analyzes the influence of Sustainability Reporting on the financial performance of energy sector companies listed on the Indonesia Stock Exchange using a panel data regression. This study uses secondary data from Sustainability Reporting and financial reports of energy sector companies listed on the Indonesia Stock Exchange. Research findings on the Random Effect Model show that environmental, social, and governance performance scores do not have a significant effect on a company's financial performance. This is possible due to limited transparency regarding Sustainability Report performance scores. Leverage and company size contribute significantly to the company's financial performance. The publication of easily accessible financial reports makes investors take these two things into account as determinants of a company's financial performance. These research findings provide input for the Financial Services Authority to further encourage the publication of Sustainability Reports and publish company rankings based on their Sustainability Report performance. Future research may observe certain sectors with specific characteristics, and add intervening or moderating variables according to previous research findings.

*Published by LPPM Usahid*
*ISSN 2797-2917 –* 

## 1. INTRODUCTION

Sustainability Reporting provides stakeholders with an understanding of the impact of sustainability on the company's main business activities and the strategic actions taken by the company in response to this impact. Sustainability Reporting reflects the company's accountability in carrying out its business affairs responsibly so that stakeholders can evaluate its implementation (https://nccr.id/). Sustainability Reporting also shows the company's empathy for the Sustainable Development Goals which have been adopted by all United Nations member countries since 2015 (https://sdgs.un.org/goals).

Elkington & Rowlands (1999) stated that corporate sustainability is operationalized through the concept of The Triple Bottom Line which consists of environmental, social, and governance factors. This approach determines that value creation is not only limited to shareholders but also to all stakeholders related to the business. Companies can optimize their revenues so that they meet the economic needs of their stakeholders without harming the environment (Ebner & Baumgartner, 2006; Situmorang & Al-Afgani, 2023). A managed environment and good social performance will guarantee a harmonious relationship between the company and its stakeholders, strengthen business ethics, and guarantee the company's sustainability in the future (United Nations, 1998; Fiscarina & Paranita, 2023; Situmorang & Al-Afgani, 2023).

DOI: http://dx.doi.org/10.36441/jamr

Law Number 40 of 2007 concerning Limited Liability Companies stipulates that environmental responsibility is a company's commitment to improving the quality of the environment and the quality of life. Companies are required to report and disclose social and environmental responsibilities for those who utilize natural resources. Sustainability Reporting is very important for controlling global warming and is still a central issue in the business world in Indonesia (Syahadat, 2022). Financial Accounting Standards (SAK) in Indonesia do not require all companies to disclose Sustainability Reporting every year. However, the Financial Services Authority through POJK No. 51/POJK.03/2017 stipulates that Financial Services Institutions, Issuers, and Public Companies are required to prepare Sustainability Reporting separately or as part of their Annual Report.

The Financial Services Authority has made Sustainability Reporting mandatory for financial institutions and companies listed on the Indonesia Stock Exchange since 2020. The conditions of the Covid-19 pandemic have pushed back its implementation until 2021. In 2022, 80 percent of companies listed on the Indonesia Stock Exchange will have disclosed Sustainability Reporting. The report shows a response to the risks of global climate change, as well as a vehicle for reporting environmental, social, and governance performance so that it reflects credibility to the public (Price Water House, 2023).

Companies that care about environmental, social, and governance issues have a competitive advantage and increase their reputation (El Idrissi et al., 2020; Vigliarolo, 2020; Chehabeddine & Tvaronaviciene, 2020). Sustainability Reporting is a form of transparency, accountability, and performance to meet stakeholder information needs and increase company value (Kaymak & Bektas, 2017; Chand et al., 2017; Fiscarina & Paranita, 2023).

Research on the role of Sustainability Reporting on company performance in developed countries produces ambiguous findings. Studies on companies in Canada conclude the positive influence of Sustainability Reporting on company performance (Abukari et al., 2023). Research on global agribusiness companies also comes to the same conclusion (Vitale et al., 2022). Research on companies in New Zealand concluded that there was no effect of Sustainability Reporting on financial performance (Carvajal & Nadeem, 2022). This research is not in line with research on global energy sector companies in fifty countries (Alhawaj et al., 2023), but strengthens the conclusion of research on food industry companies and companies in Sweden that there is no effect of Sustainability Reporting on financial performance (Bahadori et al., 2021; Pham et al., 2021).

Companies in the United States, Australia, and China show the positive influence of Sustainability Reporting on financial performance (Ademi & Klungseth, 2022; Nguyen et al., 2022; Zhou et al., 2022). In contrast, companies in the Nordic Region show a negative influence of Sustainability Reporting on financial performance (Rahi et al., 2022). Comparative studies of company performance in developed and developing countries during the Covid-19 pandemic show that Sustainability Reporting has a positive effect on financial performance, where the financial performance of companies in developing countries is better than in developed countries (Lu & Khan, 2023).

Research in developing countries produces more varied conclusions. Research on companies in Indonesia shows that the influence of Sustainability Reporting on company performance is moderated by family ownership (Zarefar et al., 2022). On the other hand, research on companies in Nigeria concluded that there was no effect of Sustainability Reporting on company financial performance (Taiwo et al., 2022); in line with research on companies in Brazil (Ching et al., 2017). Apart from that, research on companies in India even shows the negative influence of Sustainability Reporting on company performance (Jyoti & Khanna, 2021).

Several studies related to the influence of Sustainability Reporting on the financial performance of companies in Indonesia have produced interesting findings that need to be followed up. Zarefar et al. (2022) concluded that Sustainability Reporting has a significant positive effect on financial performance. On the other hand, Rudyanto & Pidzarda (2021) stated that Sustainability Reporting has an effect on company value in companies categorized as sensitive to environmental issues, but the opposite is true for companies categorized as non-sensitive to environmental issues. Apart from that, Devie et al. (2020), who analyzed the financial performance of energy sector companies, concluded that Sustainability Reporting had a positive effect on financial performance, but only in a long-term context.

DOI: http://dx.doi.org/10.36441/jamr

Referring to research gaps and business phenomena in Indonesia, it is interesting to analyze the role of Sustainability Reporting in improving the financial performance of energy sector companies as the sector most sensitive to environmental issues. Research regarding the role of Sustainability Reporting on company financial performance, especially in companies sensitive to environmental issues, is interesting to follow up on (Zarefar et al., 2022; Rudyanto & Pidzarda, 2021; Devie et al., 2020). Thus, this research aims to analyze the influence of Sustainability Reporting on financial performance in energy sector companies in Indonesia. In line with Stakeholder Theory and Sustainability Theory as well as previous research findings that disclosure of Sustainability Reporting will have the potential to improve financial performance, a hypothesis was formulated: disclosure of Sustainability Reporting will contribute positively to increasing the company's financial performance.

This research enriches the framework of Stakeholder Theory and Sustainability Theory based on the implementation of Sustainability Reporting in energy sector companies. Apart from that, this research is specifically novel because it empirically tests the influence of Sustainability Reporting on the financial performance of energy sector companies from the period before the Covid-19 pandemic to the new normal conditions after the Covid-19 pandemic. To produce a meaningful scientific contribution and refer to the findings of previous research, this research adds the control variables of leverage and firm size.

## 2. RESEARCH METHOD

**Research Design.** This study is a quantitative approach research using content analysis based on disclosures from the Standard Global Reporting Initiative (GRI) of corporate Sustainability Reporting from the Airlangga University ESGI database website, adopting the measurements of Laskar & Maji (2018) and Hussain (2022). Sustainability Reporting performance is broken down into environmental, social, and governance performance, each of which is measured by the score on the items disclosed by the company compared to the Standard Global Reporting Initiative (GRI) items that should be disclosed. Additionally, data obtained from Annual Financial Reports in the form of audited Balance Sheets and Profit and Loss Statements published on the Indonesia Stock Exchange website.

**Population and Sample.** The population of this research is all energy sector companies listed on the Indonesia Stock Exchange in 2018-2022. The sampling technique in this research is the non-probability sampling category, namely purposive sampling based on specific criteria: energy sector companies that publish Sustainability Reporting and financial reports consecutively in the 2018-2022 period. Based on these criteria, 12 companies were selected as samples or 60 data over five years.

**Analysis Technique.** This research analysis uses panel data regression because it has advantages: a combination of time-series and cross-section observations so that the data is more informative, and varied, and the collinearity between variables is smaller. There are three estimation models in panel data regression, namely the Common Effect Model (CEM), the Fixed Effect Model (FEM), and the Random Effect Model (REM). To determine the best model for this research, a model estimation test was carried out. The Chow test is used to determine the best model estimate between the Common Effect Model (CEM) and the Fixed Effect Model (FEM). The Hausman test is used to determine the best model estimate between the Fixed Effect Model (FEM) and the Random Effect Model (REM) (Gujarati, 2015). Next, a classical assumption test is carried out on the model to ensure that the regression equation has accurate estimates, is not biased, and is consistent. In panel data regression, only multicollinearity and heteroscedasticity tests are needed (Basuki & Yuliadi, 2015).

To control the significant influence of capital structure on financial performance, and on the premise that the greater the debt ratio, the more impact it will have on financial performance, leverage is used as a control variable (Zarefar et al., 2022; Carvajal & Nadeem, 2022; Laskar & Maji, 2018). The choice of firm size as a control variable is based on the premise that the larger the company, the more complex its operational activities which impact its stakeholders (Fadhilla et al., 2023; Carvajal & Nadeem, 2022; Zarefar et al., 2022; Laskar & Maji, 2018).

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The operational definition of each research variable is presented in Table 1. Based on the research hypothesis, the following research equation is proposed:

$$Tobin's\ Q = \beta_0 + \beta_1 E\_Score + \beta_2 S\_Score + \beta_3 G\_Score + \beta_4 Lev + \beta_5 FSize + \varepsilon$$

Notes:
Tobin's Q : Financial Performance
$\beta_0$ : Intercept
$\beta_{1,2,3,4,5}$ : Regression Coefficients
E_Score : Environment Score
S_Score : Social Score
G_Score : Governance Score
Lev : Leverage
FSize : Firm Size
$\varepsilon$ : Error Term

**Table 1. Variable Operationalization**

| Variable | Concept | Proxy |
|---|---|---|
| Financial Performance | Capitalization of the company's market value divided by total assets. | Tobin's Q (Abukari et al., 2023; Ademi & Klungseth, 2022; Nguyen et al., 2022; Vitale et al., 2022; Zhou et al., 2022) |
| Sustainability Reporting | Disclosed items are compared with Standard Global Reporting Initiative items that should be disclosed. | Environment Score, Social Score, Governance Score (Eliyana & Subakir, 2020; Aydogmus et al., 2022) |
| Leverage | The level of debt incurred by a business entity against total assets. | Debt to Total Assets Ratio (Eliyana & Subakir, 2020; Aydogmus et al.., 2022) |
| Firm Size | Scale that shows how big or small a company is. | Ln Total Assets (Jyoti & Khanna, 2021; Pham et al., 2021; Rahi et al., 2022) |

## 3. RESULTS AND DISCUSSIONS

**Descriptive Statistic**. Descriptive statistical analysis of all variables is shown in Table 2. The average Tobin's Q is 0.969 with a standard deviation of 0.337, a minimum value of 0.490, and a maximum value of 2.376. So in general, the sample companies in this research are companies with high market value because their market value capitalization is above 90 percent compared to their asset value. The average E_Score is 0.502 with a standard deviation of 0.273, a minimum value of 0.000, and a maximum value of 1.000. This shows that environmental performance disclosure in the sample companies in this study is moderate.

**Table 2. Descriptive Statistic**

| | TobinsQ | E_Score | S_Score | G_Score | Lev | FSize |
|---|---|---|---|---|---|---|
| Mean | 0.969412 | 0.501711 | 0.576899 | 0.693400 | 0.467544 | 30.57941 |
| Median | 0.893750 | 0.485295 | 0.600000 | 0.832165 | 0.476095 | 30.69170 |
| Maximum | 2.376300 | 1.000000 | 1.000000 | 1.000000 | 0.961310 | 32.76456 |
| Minimum | 0.490220 | 0.000000 | 0.000000 | 0.000000 | 0.048030 | 28.56111 |
| Std. Dev. | 0.337419 | 0.273057 | 0.254110 | 0.336288 | 0.190420 | 1.238075 |
| Skewness | 1.308690 | 0.325874 | 0.093967 | 0.667020 | 0.357689 | 0.308570 |
| Kurtosis | 6.411845 | 2.286410 | 2.125183 | 2.022743 | 3.041214 | 1.736944 |
| Observations | 60 | 60 | 60 | 60 | 60 | 60 |

The average S Score is 0.576 with a standard deviation of 0.254, a minimum value of 0.000, and a maximum value of 1.000. This shows that the disclosure of social performance in the sample companies in this study is moderate. The average G Score is 0.693 with a standard deviation of 0.336, a minimum value of 0.000, and a maximum value of 1.000. This shows that the disclosure of governance performance in the companies sampled in this study is higher than the disclosure of their environmental and social performance.

**Model Estimation Test**. The Chow Test results are summarized in Table 3. The Chow Test is used to test the null hypothesis that the estimator of the Fixed Effect Model is no different from the Common Effect Model. The F statistic value of 10.344 with a probability of 0.000 is significant at α = 0.05 indicating that the null hypothesis is rejected, so the Fixed Effect Model is more appropriate than the Common Effect Model.

**Table 3. Chow Test**

Redundant Fixed Effects Tests
Equation: Untitled
Test cross-section fixed effects

| Effects Test | Statistic | d.f. | Prob. |
|---|---|---|---|
| Cross-section F | 10.334148 | (11,43) | 0.0000 |
| Cross-section Chi-square | 77.578648 | 11 | 0.0000 |

The Hausman Test results are summarized in Table 4. The Hausman Test is used to test the null hypothesis that the Random Effect Model estimator is no different from the Fixed Effect Model. The Chi Square statistic value of 2.177 with a probability of 0.824 is not significant at α = 0.05 indicating that the null hypothesis cannot be rejected, so the Random Effect Model is more appropriate than the Fixed Effect Model. Because the results of the Chow Test and Hausman Test indicated different model estimates, the Langrange Multiplier Test was carried out.

**Table 4. Hausman Test**

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

| Test Summary | Chi-Sq. Statistic | Chi-Sq. d.f. | Prob. |
|---|---|---|---|
| Cross-section random | 2.177389 | 5 | 0.8241 |

The Langrange Multiplier Test results are summarized in Table 5. The Langrange Multiplier Test is used to test the null hypothesis that the Random Effect Model estimator is no different from the Fixed Effect Model. The Chi Square statistic value of 45.759 with a probability of 0.000 is significant at α = 0.05 indicating that the null hypothesis is rejected, so the Random Effect Model is more appropriate than the Fixed Effect Model.

**Table 5. Langrange Multiplier Test**

Lagrange Multiplier Tests for Random Effects
Null hypotheses: No effects
Alternative hypotheses: Two-sided (Breusch-Pagan) and one-sided (all others) alternatives

| | Test Hypothesis | | |
|---|---|---|---|
| | Cross-section | Time | Both |
| Breusch-Pagan | 45.75962 | 1.077145 | 46.83677 |
| | (0.0000) | (0.2993) | (0.0000) |

DOI: http://dx.doi.org/10.36441/jamr

Based on the three model estimation tests, it can be stated that the most appropriate model is the Random Effect Model. Next, a classical assumption test was carried out on the model.

**Classic Assumption Test.** Multicollinearity test to detect high correlation between independent variables can be done by monitoring the correlation coefficient value. Table 6 shows that all correlation coefficient values between independent variables are < 0.8 so it can be stated that there is no indication of multicollinearity in this regression model.

**Table 6. Multicollinearity Test**

| | X1 | X2 | X3 | LEV | FSIZE |
|---|---|---|---|---|---|
| X1 | 1.00000 | 0.67064 | 0.41565 | 1.02623 | 0.36696 |
| X2 | 0.67063 | 1.00000 | 0.22648 | 0.07118 | 0.32594 |
| X3 | 0.41565 | 0.22648 | 1.00000 | 0.27116 | 0.38328 |
| LEV | 0.01613 | 0.07118 | 0.27116 | 1.00000 | 0.45346 |
| FSIZE | 0.36696 | 0.32594 | 0.38328 | 0.45346 | 1.00000 |

Heteroscedasticity test to test whether there is an inequality of residual from one observation to another, by regressing the independent variable on the absolute value of the residual. Table 7 shows that all probability t-statistic values are > 0.05, meaning there is no indication of heteroscedasticity in this regression model.

**Table 7. Heteroscedasticity Test**

Dependent Variable: ABSRES
Method: Panel EGLS (Cross-section random effects)
Sample: 2018 2022
Periods included: 5
Cross-sections included: 12
Total panel (balanced) observations: 60
Swamy and Arora estimator of component variances

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| C | -0.791828 | 0.926049 | -0.855060 | 0.3963 |
| X1 | -0.038623 | 0.123479 | -0.312789 | 0.7556 |
| X2 | -0.065944 | 0.122648 | -0.537667 | 0.5930 |
| X3 | -0.113865 | 0.075758 | -1.503019 | 0.1387 |
| LEV | -0.269808 | 0.177312 | -1.521660 | 0.1339 |
| FSIZE | 0.041544 | 0.031989 | 1.298689 | 0.1996 |

The results of panel data regression analysis with the Random Effect Model are shown in Table 8. Thus, the regression equation for this research is:

Tobin's Q = - 3.605 - 0.064 E_Score + 0.135 S_Score + 0.047 G_Score - 0.407 Lev + 0.153 FSize + ε

The influence of E_Score on Tobin's Q financial performance with a coefficient value of -0.064 is not in the same direction as the hypothesis. However, the probability of the t-statistic value is 0.7629 > 0.05 so the influence of environmental performance on financial performance is not significant. This is in line with the research of Rahi et al. (2022), but does not support the research of Ademi & Klungseth (2022) and Zarefar et al. (2022). The influence of S_Score on financial performance with a coefficient value of 0.135 is in the same direction as the hypothesis. However, the probability of the t-statistic value is 0.5190 > 0.05 so the influence of S Score on financial performance is not significant. This is in line with research by Carvajal & Nadeem (2022) and Alhawaj et al. (2023). The influence of G Score on financial performance with a coefficient value of 0.047 is in the same direction as the hypothesis. However, the probability of the t-statistic value is 0.7278 > 0.05 so the influence of G Score on financial performance is not significant. This is in line with research by Alhawaj et al. (2023) and Buallay (2022). Empirical research findings regarding the insignificant influence of the Sustainability Report on the financial performance in the energy sector companies are because the market does not yet consider environmental, social and governance performance as the basis for its decision making.

**Tabel 8. Random Effect Model**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| C | -3.605044 | 1.107617 | -3.254775 | 0.0020 |
| X1 | -0.064073 | 0.211289 | -0.303250 | 0.7629 |
| X2 | 0.135277 | 0.208414 | 0.649079 | 0.5190 |
| X3 | 0.047227 | 0.134986 | 0.349865 | 0.7278 |
| LEV | -0.407576 | 0.236538 | -1.723085 | 0.0906 |
| FSIZE | 0.153253 | 0.039056 | 3.923910 | 0.0002 |
| R-squared | 0.288022 | Mean dependent var | | 0.969412 |
| Adjusted R-squared | 0.222098 | S.D. dependent var | | 0.337149 |
| S.E. of regression | 0.297362 | Akaike info criterion | | 0.506904 |
| Sum squared resid | 4.774891 | Schwarz criterion | | 0.716338 |
| Log likelihood | -9.207112 | Hannan-Quinn criter. | | 0.588825 |
| F-statistic | 4.369003 | Durbin-Watson stat | | 0.619783 |
| Prob(F-statistic) | 0.002064 | | | |

The effect of leverage on financial performance with a coefficient value of -0.407 and the t-statistic value being 0.0906 > 0.05 shows that leverage does control the influence of the Sustainability Report on financial performance. The probability of the t-statistic value > 0.05 but still < 0.10, so it is proven that leverage controls the influence of the Sustainability Report on financial performance at the 10 percent significance level. The higher the debt structure, the higher the risk, so that company valuation will decrease; and vice versa. This is in line with research by Jyoti & Khanna (2021); Rahi et al. (2022); Pham et al. (2021); Zhou et al. (2022); and Ademi & Klungseth (2022).

The influence of firm size on financial performance with a coefficient value of 0.153 and the t-statistic value is 0.0002 < 0.05 is proven that leverage does control the influence of the Sustainability Report on financial performance. The larger the company size, the more stable the management, so the company valuation will increase; and vice versa. Research findings related to control variables show that investor decision making in companies in the energy industry takes into account debt structure and company size. This is in line with research by Kim et al. (2021); Jyoti & Khanna (2021); Rahi et al. (2022); Pham et al. (2021).

The probability of an F-statistic value of 0.002 < 0.05 indicates that all Sustainability Report score simultaneously have a significant effect on financial performance. This findings supports the research of Zarefar et al., (2022), Rudyanto & Pidzarda (2021), and Devie et al., (2020). However, the Adjusted R-Squared of 0.22 reveal that the research model is only explain 22 percent of the variation in financial performance, while 78 percent is explained by other variables outside this research model. So far there is very limited research on Sustainability Report scores or company rankings based on Sustainability Report score on the Indonesian Stock Exchange.

## 4. CONCLUSION

The environmental, social and governance performance scores partially show an insignificant influence on the company's financial performance, but simultaneously all of these scores have a significant influence. This is possible because the market has not yet considered each Sustainability Report performance score as a crucial factor as a basis for decision making for companies in the energy industry. Limited transparency regarding the Sustainability Report scores is also the reason why investors do not take it into account as a determinant of the financial performance of energy sector companies. Leverage and company size are proven to control the influence of the Sustainability Report on the company's financial performance. The publication of financial reports and a resume of financial ratios that are easily accessible causes investors to really take these two things into account as a basis for their decision making. The results of this research provide input for the Financial Services Authority to further encourage the publication of Sustainability Reports and publish company rankings based on their Sustainability Report performance.

DOI: http://dx.doi.org/10.36441/jamr

It is recommended that further research conduct observations on all sectors on the Indonesia Stock Exchange by adding the industrial sector as a control variable considering that each company sector has specific characteristics. To obtain more comprehensive conclusions, future research can observe over a longer period and add intervening or moderating variables according to the findings of previous studies.

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