Integration of Environmental, Social and Governance (ESG) Factors in Financial Reporting: A Global Perspective

Integrasi Faktor Environment, Social, dan Governance (ESG) dalam Pelaporan Keuangan: Perspektif Global

Yanti Budiasih
Institut Teknologi Dan Bisnis Ahmad Dahlan Jakarta
*budiasihyanti@gmail.com

*Corresponding Author

ABSTRACT

The integration of Environmental, Social and Governance (ESG) considerations in financial reporting is increasingly receiving significant attention, driven by increasing investor demand and corporate social responsibility. Internal factors in an organization, such as the composition of the board of directors, financial performance, internal control system, corporate governance, and institutional environment, have a significant influence on ESG integration. This research analyzes the role of internal factors in influencing ESG practices, highlighting the importance of diverse leadership, financial stability, effective control systems, disclosure transparency, and a stable institutional environment. By paying attention to these factors, companies can improve their ESG practices, reduce risks, and make a greater contribution to sustainable economic, social, and environmental development.

Keywords: ESG Integration, Financial Reporting, Composition of the Board of Directors, Financial Performance, Internal Control System, Corporate Governance, Institutional Environment.

ABSTRAK

Integrasi pertimbangan Lingkungan, Sosial dan Tata Kelola (ESG) dalam pelaporan keuangan semakin mendapat perhatian signifikan, didorong oleh meningkatnya permintaan investor dan tanggung jawab sosial perusahaan. Faktor internal suatu organisasi seperti komposisi dewan direksi, kinerja keuangan, sistem pengendalian internal, tata kelola perusahaan, dan lingkungan kelembagaan mempunyai pengaruh yang signifikan terhadap integrasi LST. Penelitian ini menganalisis peran faktor-faktor internal dalam mempengaruhi praktik-praktik ESG, menyoroti pentingnya kepemimpinan yang beragam, stabilitas keuangan, sistem pengendalian yang efektif, transparansi pengungkapan, dan lingkungan kelembagaan yang stabil. Dengan memperhatikan faktor-faktor ini, perusahaan dapat meningkatkan praktik ESG mereka, mengurangi risiko, dan memberikan kontribusi yang lebih besar terhadap pembangunan ekonomi, sosial, dan lingkungan yang berkelanjutan.

1. Introduction

In this modern era, social and environmental responsibility has become a major focus for many companies around the world. As awareness of the negative impacts of business activities on the environment and society increases, more companies are looking for ways to integrate environmental, social, and corporate governance (ESG) considerations into their business practices. One of the key aspects of ESG integration is how companies report their performance in relation to these factors in their financial reports.

The integration of Environmental, Social and Governance (ESG) factors in financial reporting has received significant attention in recent years. Research has shown that incorporating ESG factors into financial reporting can have a positive impact on various aspects of business performance. For example, research by Torre et al. (2020) show that companies with high ESG scores tend to have higher excess returns and lower volatility, indicating that ESG factors are viewed positively by market players. This is further supported by the findings of (Kim & Li, 2021) which explore the relationship between ESG factors and company financial performance.

In addition, Ali’s (2023) research highlights the mediating effect of ESG performance on the relationship between executive incentive compensation and financial performance in the MENA banking sector. This underscores the importance of considering ESG factors in executive compensation structures. In addition, research by Albitar et al. (2020) investigates the impact of ESG disclosure on corporate performance, both before and after the implementation of integrated reporting, emphasizing the role of corporate governance mechanisms in moderating this relationship. Furthermore, research conducted by Park & Oh (2022) emphasizes the importance of integrating ESG information into corporate investment decisions by individual investors, showing that such integration is important for achieving positive social and environmental outcomes as well as long-term financial returns. This is in line with the broader understanding that integrating ESG factors in financial decision making will result in more sustainable and responsible investment practices.

The integration of Environmental, Social and Governance (ESG) factors into financial reporting has received significant attention globally, particularly in the context of sustainable development and corporate responsibility. This integration is driven by the increasing importance of ESG factors in investment decisions, as well as the need for companies to meet the expectations of stakeholders and regulatory bodies.

The oil and gas industry, for example, is at the forefront of this shift, with companies preparing reports on sustainable development and corporate social responsibility in addition to traditional financial reporting. The COVID-19 pandemic and the fight against corruption have further highlighted the need for companies to disclose ESG factors in their reporting, as investors seek objective, timely and complete information to make informed decisions (Derevyankina, et al. 2022).

In the banking sector, Islamic banks are also increasingly coming under scrutiny for their ESG practices, with global Islamic assets under management increasing significantly in recent years. The United Nations Sustainable Development Goals (SDGs) have created new expectations for corporate actors, and ESG reporting has become a critical component of a well-informed and strategically positioned market (Abdullah, et al. 2022). The world of finance is facing changes due to the integration of ESG factors, and financial reporting is evolving to reflect the financial implications of ESG-related products and transactions [3]. There are differences between financial audits and ESG assurance services, and some ESG-related risks and matters may be considered in the financial audit cycle (Indyk 2022).
The impact of ESG factors on financial stability has also been a topic of research, with research showing that higher ESG ratings can improve financial system stability by mitigating individual and systemic risks. However, the intensity of research within the ESG pillars varies, with more research focusing on environmental factors and corporate governance compared to social factors (Stolbov, et al. 2022).

In Russia, the ESG concept is at an early stage of development, but is gradually being introduced into financial and economic activities, and most foreign companies have included ESG indicators in their reports (Stolbov, et al. 2022). In conclusion, the integration of ESG factors into financial reporting is a global trend driven by the need for companies to be transparent about their environmental, social and governance practices. This trend is influenced by investors’ demand for reliable information and the need to address pressing global issues such as climate change, the COVID-19 pandemic and corruption.

The main objective of this research is to investigate the internal factors that influence the level of ESG integration in financial reporting in multinational companies. By understanding these factors, it is hoped that better insights will emerge on how companies can improve their financial reporting practices that take ESG aspects into account. Through this research, we aim to contribute to the understanding of ESG integration in a global context, as well as provide useful insights for multinational companies and other stakeholders interested in sustainable financial reporting practices. The main research question to be answered in this study is: "What are the internal factors that influence the level of ESG integration in financial reporting in multinational companies?". This study will focus on analyzing internal factors that influence the integration of ESG in financial reporting in multinational companies. This research will use a qualitative approach to understand these factors through a literature review and case study analysis.

2. Research methods

The research method used in this research is Systematic Literature Review (SLR). This approach was chosen because it allows a systematic and comprehensive analysis of the internal factors that influence the level of ESG integration in financial reporting in multinational companies, based on findings that have been published in the scientific literature.

This research design involves systematic steps in searching, reviewing, and analyzing scientific literature relevant to the research topic. This process includes identification of a clear research question, development of a research protocol, literature search, study selection, data extraction, and analysis of findings. This study used a protocol that described search procedures, inclusion and exclusion criteria, and analysis methods that had been developed before carrying out the SLR. This protocol helps ensure that research is conducted systematically and consistently. Literature searches were carried out through academic databases such as Google Scholar, Scopus, Web of Science, and ProQuest. Keywords relevant to the research topic were used to identify appropriate articles. Relevant studies were selected based on established inclusion and exclusion criteria. Inclusion criteria included topic relevance, methodological clarity, and research quality. Studies that met these criteria were then included in the analysis. Relevant data from the selected studies were extracted using a previously prepared data extraction form. The extracted data includes information on internal factors that influence the integration of ESG in financial reporting.

Analysis of findings was carried out by examining common patterns and findings from the extracted studies. The data found was organized and synthesized to provide a comprehensive understanding of the internal factors influencing the integration of ESG in financial reporting in multinational companies. The Systematic Literature Review method is used in this research to identify, review and analyze scientific literature relevant to the research topic. This approach allows developing an in-depth understanding of the internal factors that
influence the integration of ESG in financial reporting in multinational companies, based on existing evidence in the scientific literature.

3. Results and Discussions

3.1 Concept of ESG Integration in Financial Reporting

The integration of ESG in financial reporting has received significant attention in recent years. Studies such as Buallay (2019) and Albitar et al. (2020) highlight the positive relationship between sustainability reporting (ESG) and financial performance in sectors such as banking. These reports emphasize the transparency that ESG disclosures bring, demonstrating the link between financial metrics and ESG factors.

Investors are increasingly incorporating ESG information into their decision-making processes. Research conducted by Amel-Zadeh & Serafeim (2018) investigated how investors utilize ESG information to assess financial performance and the relevance of ESG integration strategies in the future. This trend is further supported by research such as (Park & Oh, 2022), which emphasizes the importance of integrating ESG information to achieve positive social, environmental and financial outcomes.

Furthermore, the concept of ESG integration goes beyond reporting. This involves integrating ESG factors into investment management and portfolio construction to enhance value and mitigate risk, as discussed by (Kim & Li, 2021). Additionally, the integration of ESG factors is seen as a method for selecting sustainable investments, which is in line with recent trends in business and academic literature.

The integration of ESG considerations into financial reporting is becoming increasingly important for companies and investors. This not only increases transparency and understanding but also plays an important role in the decision-making process, value creation and risk management in the financial sector.

3.2 Internal Factors Affecting ESG Integration

Internal factors are critical in influencing the integration of Environmental, Social and Governance (ESG) considerations within an organization. Factors such as board composition, profitability, leverage, and internal control systems have been identified as significant determinants influencing ESG integration (Balogh et al., 2022; Harasheh & Provasi, 2022; Arayssi et al., 2020). Board composition, including aspects such as diversity and expertise, can impact the level of ESG disclosure a company makes (Arayssi et al., 2020). Profitability and leverage also play a role in shaping ESG practices in organizations (Balogh et al., 2022). Internal control systems are very important to detect fraud risks that can hinder the effective development of ESG integration (Harasheh & Provasi, 2022).

Additionally, the integration of ESG factors into business models involves consideration across multiple dimensions such as value proposition, creation, delivery, and capture (Aldowaish et al., 2022). This holistic approach ensures that ESG issues are embedded in the core operations of the business. Additionally, the role of governance, including ESG disclosure, is highlighted as an important factor in enhancing green innovation in organizations (Mukhtar et al., 2023). Additionally, the impact of board factors, including gender diversity, has been studied in relation to ESG disclosure scores, with larger board sizes increasing ESG disclosure by bringing diverse perspectives (Bhatia & Marwaha, 2022). The institutional environment also plays an important role in influencing ESG performance, and institutional quality has a major impact on ESG performance outcomes (Pinheiro, 2023).

Internal factors within an organization, such as the composition of the board of directors, profitability, internal control systems, and governance structure, are critical in driving
the integration of ESG considerations. By effectively addressing these internal factors, organizations can improve their ESG practices and contribute to sustainable and responsible business operations.

3.3 The Role of Multinational Companies in the Global Context

Multinational corporations play an important role in the global context by actively participating in international laws, promoting international responsibility, and encouraging ethical practices (Yang, 2023; Zhang et al., 2022). These companies play an important role in driving innovation, such as in the agri-food sector, and are considered key agents of globalization (Mesa & Gómez, 2010; Palmisano, 2006). Multinational companies are increasingly focusing on global personnel policies and developing appropriate global personnel to navigate the complexities of the international business environment (Zhang, 2021).

Additionally, multinational companies are at the forefront of corporate social responsibility (CSR) practices, driving CSR convergence globally and communicating sustainability disclosures proactively (Szántó, 2018; Carini et al., 2020). They also face challenges related to quality management systems, institutional distance, and tax practices, highlighting the complexity of their operations in different countries (Bashan & Notea, 2018; Krajnović, 2020; Masri, 2021).

The cognitive orientation of managers in multinational companies is increasingly important, with concepts such as ‘global mindset’ being linked to effective management practices in these complex organizations (Levy et al., 2007). In addition, the entry of new multinational companies from developing countries into developed countries’ markets is reshaping the global competitive landscape (Zahra et al., 2011).

Multinational corporations play an important role in shaping employment, work practices, and industrial relations in the global economy, where their decisions have national and corporate influence (Marginson, 1994; Edwards et al., 2015). They are also key players in global supply chains, where the feasibility of using contract law to enhance corporate social responsibility is being explored (Zhang & Xie, 2023). Multinational companies not only drive economic growth and innovation but also influence global governance, sustainability practices, and workforce dynamics, making them central players in the interconnected business world.

From the results and discussion that have been presented, hypotheses that can be proposed focus on internal factors that influence the integration of Environmental, Social and Governance (ESG) considerations in organizations. The following are several hypotheses that can be proposed:

**Hypothesis 1**

The composition of a board of directors that is more diverse and has relevant expertise will be positively related to the level of ESG disclosure made by the company.

**Hypothesis 2**

A high level of profitability will be positively related to better ESG practices in the organization.

**Hypothesis 3**

Low leverage will be positively related to more effective ESG integration in corporate structures and policies.

**Hypothesis 4**

A strong and efficient internal control system will be positively associated with a higher level of ESG integration within the organization.
**Hypothesis 5**

Good corporate governance, including transparent ESG disclosure, will be positively related to green innovation in organizations.

**Hypothesis 6**

A more stable and quality institutional environment will be positively related to better ESG performance in companies.

Testing these hypotheses can provide deeper insight into what internal factors have a significant influence on the integration of ESG in a company's business practices.

4. **Conclusions**

Based on the results of the discussion regarding internal factors that influence the integration of Environmental, Social and Governance (ESG) considerations in organizations, several important things can be concluded:

1. **Composition of the Board of Directors**

   The composition of a board of directors that is diverse and has relevant expertise can influence the level of a company's ESG disclosure. This highlights the importance of diverse leadership and having a deep understanding of ESG issues in driving corporate strategy.

2. **Financial Performance and Leverage**

   Good financial performance, such as high levels of profitability and low leverage, can support better ESG practices in organizations. This suggests that financially stable companies are more likely to be able to invest in ESG initiatives.

3. **Internal Control System**

   A strong and efficient internal control system is key in supporting effective ESG integration in company structures and policies. This shows that risk management and compliance with ESG standards is an integral part of good corporate governance.

4. **Corporate governance**

   Good corporate governance, including transparent ESG disclosure, can encourage green innovation in organizations. This illustrates the importance of transparency and accountability in promoting socially and environmentally responsible business practices.

5. **Institutional Environment**

   The quality of the institutional environment can also influence a company's ESG performance. With a stable and quality institutional environment, companies are likely to have better support to implement effective ESG practices.

   By paying attention to these internal factors, organizations can identify areas where they can improve their ESG integration. Overall, a deep understanding of these factors can help companies strengthen their ESG practices, which in turn will have a positive impact on corporate value and their contribution to sustainable economic, social and environmental development.

5. **References**


