Available online at www.rajournals.in
International Journal of Management and Economics Invention
ISSN: 2395-7220
DOI: 10.47191/ijmei/v11i1.13
Volume: 11 Issue: 01 January 2025
International Open Access
Impact Factor: 8.473 (SJIF)
Page no. 3905-3912

The Effect of ESG Ratings Information on Share Prices

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ARTICLE INFO

Published Online:
27 January 2025

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ABSTRACT

With various encouragement from the world community since the Paris Agreement, companies continue to be encouraged to implement sustainable activities. For this reason, the government through the Financial Services Authority has required public companies to report sustainability activities, also known as ESG (Environment, Social and Governance). The latest development is that public companies listed on the Indonesia Stock Exchange (BEI) are also being assessed regarding ESG activities, which is being carried out by an independent party, namely Morningstar Sustainalitycs. The assessment submitted to the public is related to the score or value of the ESG activities carried out by the company, including whether there is a decrease or increase in value from the previous assessment. This research aims to see whether ESG value information also influences investors' assessments of companies, which is proxied by the company's share price. This research was concluded that there was an influence of information on the decline of ESG risk value provided by the IDX on company share prices using the linear regression statistical method. However the information regarding the ESG Risk clasiffication did not have significant moderating effect on the share price. It is hoped that the implications of this research will increase investor awareness of ESG activities, which will ultimately encourage companies to implement ESG activities seriously.

KEYWORDS: ESG Risk Value, Share Price, Morningstar Sustainalytics

I. INTRODUCTION

With its strategic geographical location, abundant natural wealth and very high cultural diversity, Indonesia is indeed worthy of being the world's focus regarding environmental, social and governance (ESG) sustainability activities. Since the Indonesian government's commitment in the Paris Agreement to support the SDGs, Indonesia has realized the urgency to achieve these goals as soon as possible. The Indonesian government has implemented a holistic and massive strategy by issuing regulations through the Financial Services Authority. With the issuance of POJK No.51/OJK.03/2017 concerning the obligation of public companies to report sustainability activities, companies are forced to carry out sustainability activities (POJK No.51/POJK.03/2017 Concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2017) . The regulation will require companies to carry out business activities that support sustainability. With this strategy, the Government is trying to roll out a snowball where it is hoped that the implementation of sustainability activities by public companies will provide a domino effect that will ultimately embrace all elements of society to integrate sustainability into every daily activity in a real way.

The implementation of the regulation was hampered by the Covid-19 pandemic, which forced companies to focus more on generating financial income rather than carrying out sustainability activities that were considered to drain company funds. After the pandemic, the government re-emphasized the obligation to prepare the sustainability report along with the annual financial reporting procedures, namely by issuing SE OJK No. 16/SEOJK.04/2021 (SE OJK No.16/SEOJK.04/2021 Concerning the Form and Content of Annual Reports of Issuers or Public Companies, 2021) . This means that public companies can no longer postpone the implementation of sustainability activities in their business activities.

The issuance of the POJK also indirectly contains the aim of showing investors that the Indonesian government through the Indonesia Stock Exchange has seriously responded to the issue of sustainability. The IDX certainly hopes that with the existence of sustainability reports it will invite more investors, especially opening up opportunities for investors who pay attention to sustainability issues in making their investment decisions. Although there are already guidelines for reporting activities in Appendix II (Appendix II of the Financial Services Authority Regulation Number 51/POJK.03/2017 Concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2017) , the sustainability activities carried out by companies can be very diverse, both in terms of the type of activity and in terms of its depth.

Appendix II of POJK No. 51/OJ.03/2017 is not a standard for implementing sustainability activities, but rather a guide to matters that must be reported in accordance with its regulations. The standards for implementing sustainability activities have been published by various organizations in various countries. There are quite a number of public companies in Indonesia that have implemented sustainability activities in their business operations. Generally, these companies use standards that are in accordance with those used by their associated or parent companies in countries that are more advanced in implementing sustainability activities. In Indonesia, quite a few implement GRI Standards and SASB, in addition to those published by other organizations, such as CDP, Value Reporting Foundation, CDSB and IR (Sinaga, 2023) .

Due to the differences in standards used, it is also difficult to compare sustainability activities between one company and another. As a result, it is almost impossible for investors to make comparisons between companies if sustainability reports are used as part of the basis for investment decision-making. To provide assistance to investors, at the end of 2023, the IDX appointed an independent organization, Morning Sustainalytics, to provide an assessment of sustainability activities carried out by companies. With the method used by MS in providing ESG Risk Values. MS claims that these values are information that can be compared between companies and between types of industries in general. The information provided by the IDX is the ESG value and information on increases or decreases in these values as shown in Figure 1 below:

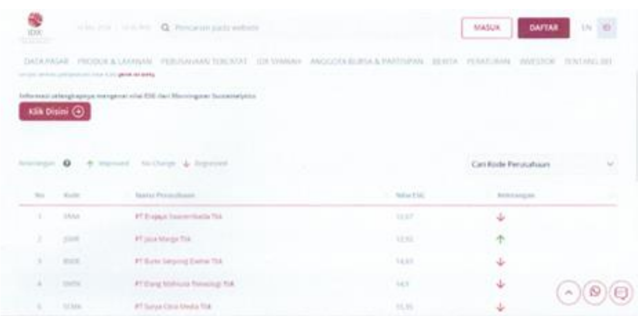

Figure 1. The Rise and Fall of ESG Values

If ESG values do have an influence on share prices, then in general it can be said that it is likely that the investing public is already aware of the importance of companies implementing ESG activities. If so, then the assumption is that investors will invest (buy shares) when they consider that the company is carrying out good ESG activities in accordance with what investors expect, so that it will have an impact on increasing the company's value. This study aims to see whether this assumption occurs, that information on the decline in ESG risk value will have an impact on increasing the company's share price.

II. LITERATURE REVIEW

A. ESG Value

Today's companies are not only required to generate profits but also must pay attention to social and environmental factors that are maintained in the process. Therefore, companies must integrate operating activities with the environment, social factors by implementing good economic governance. ESG refers to three central factors measuring the impact of sustainability and ethics in making investment decisions. These three factors are: Environmental, Social and Governance. ESG assessment is an important part of assessing the implementation of ESG practices in companies. Therefore, BEI continues to be committed to encouraging long-term sustainable investment and improving ESG practices in the Indonesian capital market by collaborating with ESG assessment institutions and conducting ESG assessments of Listed Companies on the BEI (IDX, 2023) .

Basically, the assessment of ESG implementation risk involves very complex and comprehensive factors. Between one company and another there will be no similarities, either in terms of rupiah scale, form of activity, or output or outcome produced, even if the same activity is carried out on the same object, it will not necessarily get the same results. Therefore, an appropriate quantification method is needed to be able to produce values that can be compared between companies. However, the MS used by IDX states that the ESG Risk assessment carried out with its method produces scores that can be compared between companies.

The Morning Sustainalytics valuation approach covered quite many of ESG factors, from geographical aspects, financial strength, even event history of a company, both quantitatively and qualitatively. the qualitative valuation from the managements point of view includes the impacts of severe events posed by a company which could reduce the quantitative score gained from other aspects. it also measures the strengths and weaknesses of management's ability in handling the ESG risk issues.

The approach used to measure the ESG risk was fundamental and quite comprehensive. That is why the result of the risk rating measurement was applicable to all kinds of companies. Meaning that users would be able to compare one company to another even when those companies came from different sub-industry classifications.

With this measurement the comparability of information can be assured. This is a key point which is important for investors in making their investment decisions (Sustainalytics, 2023) .

MS conducts research aimed at identifying companies involved in incidents that have the potential to harm stakeholders, the environment, or the company's operations. MS conducts ESG risk assessments using a risk decomposition approach, which considers two main dimensions in ESG issues, namely exposure and management. **Exposure** refers to the potential material ESG risks faced by the company and has an impact on the ESG risk assessment. Meanwhile, the **Management aspect** is an approach that uses a management lens in providing an explanation to users of how well the company has mitigated these risks. Management **reflects** the company's commitment and concrete steps in managing ESG issues through policies and work programs implemented (Sustainabilitycs, nd) .

The exposure dimension describes how much a company is exposed to some critical conditions which put the company under pressure regarding the overall material ESG risk and also from the detailed level of the issue. Those factors are assessed by the risk drivers which are sensitive to a company at the subindustry level. uses scoring method for quantitative data and includes some reviews from experts which can adjust the data score when necessary. The highest exposure at the sub industry level would have a score of 10 and usually the low risk was at 2, when below 2 would be considered as very immaterial. The higher the score of the risk, the less managed the ESG risk at the company and vice versa. Those unmanaged risk scores on each material ESG issues (MEIs) are then summed up to come up at the company's overall ESG Risk Rating.

Based on this analysis, MS groups companies into the category of no evidence of involvement or one of the other five categories. From these results, MS categorizes the risk scores as described in Table 1 below:

Table 1. ESG Risk Groups

Risk Score	Category	Description: Considered to have ESG risks
0 - 10	Negligible	can be ignored
10 - 20	Low	low
20 - 30	Medium	currently
30 - 40	High	tall
> 40	Severe	heavy

Source: IDX (IDX, nd)

This classification can be explained as follows (IDX, nd) :

1. In the negligible classification, company activities are considered to have a low impact on the environment and society, so that the risk can be ignored by the company.
2. In the low-risk classification, the company's activities have a moderate impact on the environment and society with minimal risk to the company, Low incident frequency. The company has a strong management system and / or actions taken to mitigate risks.
3. In the medium risk classification, the company's activities have a significant impact on the environment and society with significant business risks. Evidence of structural problems in the company and / or the company has an inadequate management system.
4. In the high-risk classification, the company's activities have a high impact on the environment and society with high business risks. Structural/systemic problems, recurring incidents and the company has an inadequate management system.
5. In severe classification, the company's activities have a heavy impact on the environment and society with serious business risks. Extraordinary egregious behavior, high frequency of incidents and the company has poor controversy management.

Furthermore, MS also provides an overview of the benefits of ESG Ratings scores for key stakeholders, namely investors, creditors, and the company itself. With this information, investors can identify, understand and manage their investment portfolios by incorporating ESG risk factors into them, so that it is expected to improve the long-term performance of the securities they own. Banks or creditors can expand their credit analysis including innovative lending schemes based on sustainability. For the company itself, the ESG Risk rating value will help the company understand the weaknesses that must be fixed and the advantages that can be added value for promoting the increase in the company's value in the public eye (Sustainalytics, nd).

B. Share Price and Efficient Market Hypothesis

Shares are one of the most popular financial market instruments. Issuing shares is one of the company's choices when deciding on company funding. On the other hand, shares are an investment instrument that many investors choose because shares are able to provide attractive levels of profit (IDX, 2024) .

The share price in the market is the consensus price of market players. Based on information and data, market players carry out buying and selling transactions and the agreement price becomes the market price (Kwee, 2023) .

Hartono (Hartono, 2023) defines market value as the stock price at a certain time in a market which is the result of an agreement between supply and demand from market players. The formation of this price equilibrium can be influenced by various information available in the market. A market that reacts to available information reflects efficient market conditions. Market efficiency in terms of information is based on the availability of information (Fama, 1969) , where there is information that does not need to be processed further and can widely affect market prices. However, there is also information that still needs to be processed further so that even though the information has been obtained by market players, it does not necessarily directly affect market prices because the information still needs to be interpreted further.

This study is also still based on Fama's thinking (Brigham & Daves, 2022) that in a market whose hypothesis is efficient, stock prices will continue to change with new information so quickly that it is impossible for investors to be fast enough to evaluate new information in order to take a position to always be able to take advantage of price changes due to new information. However, in reality, stock prices will continue to change with new information. With this in mind, the stock price of a company in the market can be said to be the intrinsic value of the stock. Although there are differences when viewed from the form of a weak, semi-strong and strong market, the assumption that no information is ignored by the market ensures that new information will affect the company's stock market price.

Hypothesis:

The hypothesis drawn in this study is:

Ho1: ESG risk impairment information affects stock market prices

Ha1: ESG risk impairment information does not affect stock market prices.

Ho2: ESG risk impairment information affects stock market prices with the addition of company ESG risk classification information.

Ha2: Information on ESG risk impairment does not affect stock market prices with the addition of company ESG risk classification information

III. METHODOLOGY

This study is a quantitative study with a comparative causal study that investigates the reasons for the occurrence of a phenomenon being studied (Noor, 2011) , where the independent variable is the ESG risk value, with the moderating variable of company classification and the dependent variable is the stock market price. In this case, the study begins by identifying the effect of ESG risk value on the company's stock market price, and then looking for possible causes. This study will be useful for determining the symptoms in question, namely whether ESG risk value information is ignored or not in making investment decisions. According to Fama's theory, a stock exchange is an efficient market if no information is ignored, thus the information will be reflected in the stock price (Fama, 1969)

This research uses a linear regression statistical method to find the influence of decreasing ESG values on stock market prices with additional moderating variables. The moderating variable used is the grouping of companies based on the Core Framework set by the Morningstar Sustainalytics institution, namely whether the company is included in the " negligible", "low risk", "medium risk", "high risk" or "severe " risk categories .

The resulting regression formula is a linear regression with the formula as follow:

$$Y = a + bX + e$$

Where:

Y = stock market price

X = ESG risk score

The regression formula by including the moderating variable is:

$$Y = a + bX + cZ + dXZ + e$$

Where:

Y = stock market price

X = ESG risk score

Z = company ESG risk classification

A. Data Types and Sources

The data used in this research is secondary data, namely data obtained indirectly in the form of reports that have been compiled in published archives. The data sources in this research are the ESG value of sustainability and closing share prices published on the official website of the Indonesia Stock Exchange, namely www.idx.co.id.

B. Research Population and Sample

The population in this study were companies listed on the Indonesia Stock Exchange during the research data collection period, namely 901 companies (https://www.idx.co.id/id/berita/siaran-pers/2060). The samples taken are listed companies that had an ESG assessment carried out by the Morning Systainalitics institution and experienced an increase in ESG values according to information recorded on the IDX at the time the data was taken, in the period of 15 May 2024 to 30 June 2024. To get the company's share price the data is taken in the form of closing stock prices taken on days H to H+6 from the date of the last ESG value update on the Morningstar Sustainalytics page. Apart from that, data related to the Core Framework (https://www.sustainalytics.com/esg-rating/) was also taken according to the grouping from Morningstar Sustainalytics (negigilbe, low risk, medium risk, high risk, or severe) to be used as a moderating variable.

Thus, the criteria fulfilled in selecting the research sample are as follows:

1. Companies listed on the Indonesian Stock Exchange
2. The Company has undergone an ESG assessment by the Morningstar Sustainalitycs agency
3. Companies identified as experiencing a decline in ESG values according to data available from the

last update date of Morning Systainaitycs taken in the period 15 May 2024 to 30 June 2024 from the Indonesia Stock Exchange page (https://www.idx.co.id /id/kompasi-recorded/esg-value)

4. The company has closing share price data on the Indonesia Stock Exchange page (https://www.idx.co.id/id/data-pasar/ringkasan-perdagangan/ringkasan-saham/) on day H to H+6 from the last date updates listed on the ESG rating page from Morningstar Sustainalytics (https://www.sustainalytics.com/esg-rating/).

There were 38 sample companies that met criteria 1.sd 4.

C. Operationalization Of Research Variables

This research uses 1 dependent variable, 1 independent variable and 1 moderating variable. The independent variable is the decline in ESG values, while the dependent variable is the share price. The variable which is assumed to moderate the relationship between these two variables is the risk group variable.

Independent Variables:

This research has 1 independent variable, namely the decline in ESG values reported on the IDX page during the data search period in this research, namely in March 2024.

Dependent Variables:

The dependent variable in this research is the stock market price, which is taken from the average daily closing price for 7 days after the ESG value update date from Morningstar Systainalitics during the data search period, namely between May 2024 to June 2024.

Moderating variables:

The moderating variable in this research is risk grouping based on the Core Framework established by the Morningstar Sustainalytics. For each group a dummy value is given to make it ratio data, namely as follows (Table 2):

Table 2. Company Classification and Dummy Variable Values

Classification	Variable Value
Negligible	1
Low risk	2
Medium Risk	3
High Risk	4
Severe	5

Source: Data Processing Results

D. Descriptive Statistical Analysis

Descriptive statistical analysis is a descriptive technique that provides information about the data held and does not aim to test hypotheses. This analysis is only used to present and analyze data accompanied by calculations in order to clarify the situation or characteristics of the data in question. The measurements used include sample size, minimum value, maximum value, mean value and standard deviation.

E. Classic assumption test

The classical assumption test was carried out in this research to determine whether the data meets the classical assumptions to avoid biased estimates. This is because not all data can be applied to regression. Tests carried out include normality tests, multicollinearity tests, heteroscedasticity tests and autocorrelation tests.

Multicollinearity Test

The results of the multicollinearity test produced a tolerance value of 0.101 where the Tol>0.100 criteria are met, meaning that there is no multicollinearity. The resulting VIF value of 9.919 also meets the VIF<10 criteria, meaning that there is no multicollinearity.

Normality Test

After conducting a Double Log for normality testing, a picture of the data was obtained whose frequency was normally distributed as in Figure 2

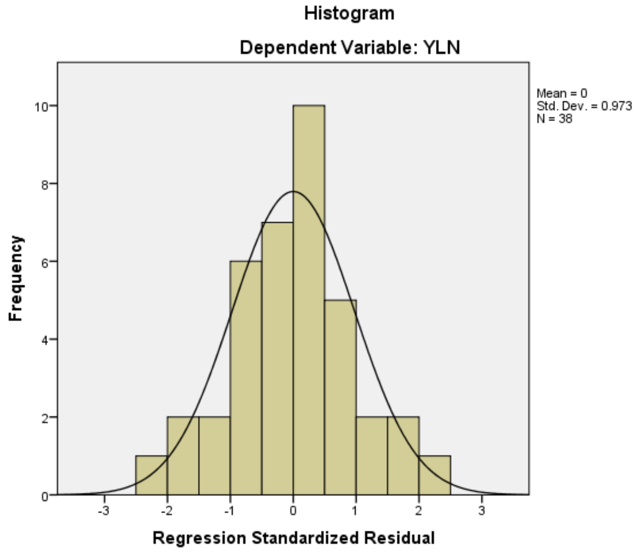

Figure 2: Histogram of Data Normality
Source: Data Processing Results

The calculation results using the one-sample Kolmogorov-Smirnov Test showed normally distributed results with a significance level of 0.876, where Sig two tail >0.05 means normally distributed.

Autocorrelation Test

For the autocorrelation test, the Durbin-Watson test was used and after data processing using the Cochrane-Orcutt test, coefficient data were obtained for transformation to the Cochrane-Orcutt, the results DW 1,799 showed no autocorrelation, as shown below:

D< 1.3177 or D> (4- 1.3177) 2.6823 → autocorrelation
1.6563 < D 1.799 < (4- 1.6563) 2.3437 → No autocorrelation
1,3177 <D<1.6563 or (4-1.6563) 2.3437 < D < (4- 1.3177) 2.6823 → No result

Heteroscedasticity Test

For heteroscedasticity testing, after Weighted Least Square was carried out, it was successful in finding that there was no heteroscedasticity in the data, where the sig level>0.05.

Table 3. Coefficients [a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3,515	2.161		1,626	.113
	X_2	.000	.001	.123	.488	.628
	Z_2	-231,187	287.021	-.202	-.805	.426

a. Dependent Variable: ABS2

Source: Data Processing Results

Regression Analysis and Hypothesis Testing

The analysis used is a simple regression method which is used to test the influence of independent variables on the dependent variable, with or without moderating variables. The statistical test for the regression model used the Fit test with a significance level of 0.05. Table 4 shows the results for the first regression formula, which is the one without the moderating variable, as follows:

Table 4. Regression Coefficients a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-2386.805	2682.997		-.890	.380
	ESG Value	193,693	88,932	.341	2.178	.036

a. Dependent Variable: Share Price

Source: Data processing results

The regression coefficient on the ESG Value variable shows a value of 0.036<0.05, which means that there is a significant influence of the variable on stock market prices. The first equation is as follows:

Share Price = -2386.805 + 193.693X + e

In addition, the level of determination is 34.1%. Which means that the stock value is influenced by 34.1% by the ESG risk value. The results conclude that the hypothesis of ESG risk reduction information affecting stock market prices is accepted.

Equation 2 includes moderating variables into the regression formula to see whether the company's ESG risk classification information variable affects stock prices. The effect of risk classification as a moderator variable is not significant with a value of 0.481, this result is greater than sig 0.05. Likewise, the interaction between ESG Value and Risk classification is also not significant, with a value of 0.056 > 0.05. These results indicate that the hypothesis of ESG risk value reduction information affecting stock market prices with additional ESG risk classification information is not accepted.

The regression equation by including the moderating variables is as follows:

Share Price = -12658.249 + 1394.805X - 2441.093Z - 161.814XZ + e

However, the level of determination after the moderating variables is 54.0%. This shows that, despite the low level of significance of the moderating variable, it had increased the contribution of the influence of the ESG Value, since after including the Risk Classification as the moderating variable, the determination value increased to the level of 54% compared to the previous calculation at 34.1%.

IV. DISCUSSION

The type and extent of information needed for investment decision making depends on the investor's intention. Currently, with the issue of sustainability in activities related to the environment, social and corporate governance, it is likely that quite a lot of investors will start to consider ethical factors related to these activities in making their investment decisions. This is supported by the IDX which provides information related to the risk of the company's ESG activities, which of course is part of the service to investors as a provision of information to add to the considerations in making investment decisions.

IDX provides information related to the ESG risk value of each company conducted by Morning Sustainalytics, an independent organization. The institution claims that the results of the risk level assessment made can be compared between companies even though they are in different industries. This will certainly help investors in considering investment decisions to buy or sell shares of public companies, which should be reflected in the stock market price.

The purpose of the study was to see the relationship between the effects of ignored information and its possible causes. In this case, it is likely that investors focus on short-term information when making decisions; ESG risk value information is new information so it is not yet known and has not been used as a factor in making investment decisions; or information from the Morning Sustainalitycs page referred to by IDX is difficult to digest, especially if investors have never studied this, for example from POJK No. 51 or other standards related to sustainability activities . Therefore, the regression method used also includes information related to the company's ESG risk grouping as a moderating variable, which is assumed to be information that is easier to digest than the risk value or number.

The results of the study on 38 public companies that have been assessed by MS show that there is a significant influence of ESG risk value information on the company's stock market price. In addition to company value information, there is also information that shows what classification the company is in regarding its sustainability activities. The 38 companies that were the research samples were divided into 5 ESG risk classifications, namely a very low level of risk that can be ignored, low risk, moderate risk, high risk, to risk that has a severe impact on ESG. This information is actually information that is easier for investors to understand. With this assumption, this information is included as a moderating variable.

After entering the moderating variable, namely information related to the existence of the company in the classification, it turns out that there is no significant increase in the influence of this information on stock market prices. However the level of determination value increased to the level of 54% compared to the previous calculation at 34.1% without the moderating variable. This can be interpreted that information about the classification of companies related to ESG activity risk groups not significantly help investors in making decisions to buy or sell, thereby affecting stock market prices. This is likely because the need of information had been sufficiently fulfilled by the ESG Risk Value scores.

V. CONCLUSION

Information on ESG risk values is relatively new information so it takes time for investors to understand it. With the various standards applied by public companies in reporting their sustainability activities, it can be an obstacle for investors to weigh and compare between companies. For relatively short-term decision making in this study, namely 7 days since the information was received, investors are encouraged to seek information that is easy to understand to support their investment decision-making considerations and the ESG Risk Value score is sufficient to meet this.

A relatively short time span only shows the results of short-term oriented investor decisions. Sustainability activities are long-term oriented activities, therefore, for further research, it can be done by taking a longer time span sample. However, it is necessary to consider other economic information or events that may affect decision makers if the time span is relatively long.

ACKNOWLEDGEMENT

We thank Widyatama University in supporting this paper research to be published.

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