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The Effect of Profitability and Leverage on Financial Performance: A Comparative Study Between Companies Included in and Not Included in The IDX ESG Quality 45 Index

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Abstract: *The increasing importance of Environmental, Social, and Governance (ESG) considerations in investment decisions has raised questions about whether financial characteristics are associated differently with financial performance across companies with different ESG classifications. This study examines the effects of profitability and leverage on financial performance and investigates whether these relationships differ between companies included in and not included in the IDX ESG Quality 45 Index. Profitability, leverage, and financial performance are measured using Return on Assets (ROA), Debt-to-Equity Ratio (DER), and Tobin's Q, respectively. Using panel data from 50 companies listed on the Indonesia Stock Exchange during 2019–2024, this study applies pooled Ordinary Least Squares (OLS) regression with interaction terms, year fixed effects, and company-clustered robust standard errors. The findings indicate that profitability has a positive and significant relationship with financial performance, with a stronger association among companies included in the IDX ESG Quality 45 Index. Leverage is not significantly associated with financial performance among companies outside the index but becomes positively associated for companies included in the index. Overall, the findings suggest that index inclusion distinguishes how profitability and leverage are associated with market-based financial performance, providing insights for investors, companies, and policymakers in evaluating firm performance.*

INTRODUCTION

Environmental, Social, and Governance (ESG) has become one of the most important considerations in corporate management and investment decision-making over the past decade. Beyond generating financial returns, companies are increasingly expected to integrate

environmental sustainability, social responsibility, and sound corporate governance into their business strategies. This shift reflects growing recognition that long-term corporate value depends not only on financial performance but also on sustainable business practices. Consequently, investors increasingly incorporate ESG-related information into their investment decisions to evaluate firms' resilience, risk management capabilities, and long-term growth potential (Clément et al., 2025; Kräussl et al., 2024).

The growing importance of ESG has also been reflected in the Indonesian capital market. Despite continuing global economic uncertainty, Indonesia has experienced significant growth in investor participation. According to the Otoritas Jasa Keuangan (2024), the number of Single Investor Identification (SID) accounts exceeded 14.81 million by the end of 2024, representing an increase of approximately 2.6 million investors within a single year. This rapid growth indicates that investors require more comprehensive information when evaluating companies, extending beyond traditional financial indicators toward sustainability-related considerations.

To facilitate sustainable investment, the Indonesia Stock Exchange (IDX), together with the KEHATI Foundation, introduced the IDX ESG Quality 45 Index, which consists of companies demonstrating relatively strong ESG performance while maintaining favorable financial quality and stock liquidity. Companies included in the index are selected using ESG Scores, ESG Controversy Screening, financial quality, and liquidity criteria, making the index a market-recognized representation of firms with relatively higher ESG quality in Indonesia (Indonesia Stock Exchange, 2021). Importantly, companies not included in the index should not automatically be classified as non-ESG companies, as exclusion may result from differences in financial quality, liquidity, or other selection criteria rather than the absence of ESG practices.

Financial performance remains one of the most important indicators of corporate success because it reflects a firm's ability to utilize resources efficiently, maintain business sustainability, and create value for shareholders. Among various performance measures, Tobin's Q is widely recognized as an appropriate market-based indicator because it captures investors' expectations regarding future growth opportunities rather than solely reflecting historical accounting performance (Tobin, 1969; Fu et al., 2016). Consequently, Tobin's Q provides a suitable measure for examining how investors value companies with different ESG-related characteristics.

Previous studies have identified profitability and leverage as two important financial characteristics associated with financial performance. Profitability reflects a company's ability to generate earnings from its assets and is generally regarded as an indicator of operational efficiency and financial strength (Sari & Witjaksono, 2021). Higher profitability is commonly associated with stronger market valuation because investors interpret higher earnings as a positive signal regarding future prospects. Conversely, leverage represents the extent to which companies rely on debt financing. While debt may facilitate business expansion and improve firm value, excessive leverage may also increase financial obligations and financial risk, potentially influencing investors' valuation of the firm (Rajkumar, 2014).

Despite extensive research examining profitability, leverage, and financial performance, previous empirical findings remain inconclusive. Several studies report a positive relationship between profitability and firm value, whereas others identify negative or insignificant effects (Jonnius & Marsudi, 2021; Panjaitan & Supriati, 2023). Similar inconsistencies are also evident regarding leverage, where some studies document positive effects while others report negative relationships (Akhtar et al., 2021; Sari & Witjaksono, 2021). Likewise, prior ESG research has produced mixed evidence regarding whether firms with stronger ESG characteristics consistently achieve superior financial performance (Aydoğmuş et al., 2022; Platsun et al., 2023; Nehrebecka

& Xing, 2023).

Furthermore, most existing studies focus primarily on ESG disclosure, ESG ratings, or comparisons between ESG-oriented and conventional firms. Relatively limited empirical evidence examines whether the relationships between profitability, leverage, and market-based financial performance differ according to inclusion in the IDX ESG Quality 45 Index, particularly within the Indonesian capital market (Mulyono, 2024). Consequently, it remains unclear whether index inclusion serves as a contextual factor that influences how financial characteristics are reflected in firm valuation.

To address this research gap, this study investigates the relationships between profitability, leverage, and financial performance while examining whether these relationships differ between companies included in and not included in the IDX ESG Quality 45 Index. Financial performance is measured using Tobin's Q, profitability is represented by Return on Assets (ROA), and leverage is measured using the Debt-to-Equity Ratio (DER). Using pooled Ordinary Least Squares (OLS) regression with interaction terms, year fixed effects, and robust standard errors, this study analyzes 300 firm-year observations from 50 companies listed on the Indonesia Stock Exchange during the 2019–2024 period. The findings are expected to contribute to the growing literature on ESG and corporate finance by providing empirical evidence regarding whether inclusion in the IDX ESG Quality 45 Index differentiates the relationships between financial characteristics and market-based financial performance, while also offering practical implications for investors, corporate managers, and policymakers.

LITERATURE REVIEW

Signaling Theory

Signaling Theory, first introduced by Spence (2002), explains that information asymmetry exists because company managers generally possess more complete information regarding a firm's current condition and future prospects than external investors. Since investors have limited access to internal corporate information, they rely on publicly available signals to evaluate a company's quality and make investment decisions. Consequently, companies are encouraged to disclose credible information that can reduce uncertainty and strengthen investors' confidence.

Within the capital market, these signals may take various forms, including financial performance, financing decisions, corporate governance practices, and sustainability-related disclosures. Positive signals are generally interpreted by investors as indicators of sound management, lower investment risk, and stronger long-term growth potential, whereas negative signals may reduce investor confidence and market valuation. Therefore, the quality and credibility of corporate information play a crucial role in shaping market perceptions and influencing firm value.

In the context of this study, profitability, leverage, and inclusion in the IDX ESG Quality 45 Index represent important corporate signals. Higher profitability may signal efficient resource utilization and stronger future earnings potential, while leverage reflects management's financing decisions and the firm's financial risk profile. Likewise, companies included in the IDX ESG Quality 45 Index provide additional signals regarding their commitment to sustainable business practices and corporate governance. These financial and non-financial signals may influence investors' perceptions, which are ultimately reflected in the company's market-based financial performance, measured using Tobin's Q.

Stakeholder Theory

Stakeholder Theory argues that companies should create value not only for shareholders but also for all stakeholders who are affected by corporate activities, including employees, customers, governments, suppliers, local communities, and investors (Hörisch et al., 2020). According to this perspective, long-term business success depends on a company's ability to balance economic objectives with social and environmental responsibilities while maintaining positive relationships with its stakeholders.

The increasing adoption of ESG practices reflects the practical application of Stakeholder Theory in modern business. Environmental protection, social responsibility, and sound corporate governance are expected to strengthen stakeholder trust, improve corporate reputation, and support sustainable value creation. Companies that effectively address stakeholder expectations are generally considered more resilient to business risks and better positioned to achieve long-term performance.

Accordingly, Stakeholder Theory provides an important conceptual foundation for this study because it explains why investors may respond differently to companies demonstrating stronger sustainability-related characteristics. Companies included in the IDX ESG Quality 45 Index are expected to exhibit greater stakeholder commitment, which may influence market perceptions and ultimately affect financial performance

Shareholder Theory

Shareholder Theory emphasizes that the primary objective of a company is to maximize shareholder wealth by improving firm value and financial performance (Friedman, 1970). Under this perspective, managerial decisions should focus on generating sustainable financial returns while utilizing corporate resources efficiently. Consequently, financial performance becomes a key indicator for evaluating whether management has successfully created value for shareholders.

To assess firm value from investors' perspective, this study employs Tobin's Q as the proxy for financial performance. Unlike accounting-based measures that primarily evaluate historical financial results, Tobin's Q incorporates market expectations regarding a firm's future growth opportunities and competitive position. Therefore, it provides a more comprehensive representation of how investors value companies operating under different financial and sustainability-related conditions.

From the perspective of Shareholder Theory, investors continuously evaluate financial information and other relevant corporate characteristics when determining firm value. Therefore, understanding how profitability, leverage, and ESG-related characteristics influence market valuation is essential for explaining differences in corporate financial performance.

Agency Theory

Agency Theory explains the contractual relationship between shareholders (principals) and managers (agents), in which managers are entrusted with making decisions on behalf of shareholders (Jensen & Meckling, 1976). Because managers generally possess greater access to internal information, differences in objectives and information asymmetry may give rise to agency conflicts. Consequently, effective monitoring mechanisms are required to ensure that managerial decisions remain aligned with shareholders' interests.

One mechanism frequently discussed within Agency Theory is capital structure. The use of debt may encourage managers to utilize corporate resources more efficiently due to fixed repayment obligations and increased monitoring by creditors. However, excessive leverage may

also increase financial risk, reduce financial flexibility, and create additional agency costs. Therefore, financing decisions represent an important aspect of corporate governance that may influence firm value and investors' perceptions.

In addition, sound corporate governance, which constitutes one of the core pillars of ESG, may reduce agency conflicts by improving transparency, accountability, and managerial oversight. Consequently, Agency Theory provides a relevant theoretical foundation for understanding how leverage and ESG-related characteristics jointly influence corporate financial performance.

Profitability and Financial Performance

Profitability reflects a firm's ability to generate earnings from its assets and is widely regarded as an important indicator of operational efficiency and financial strength. According to Signaling Theory, higher profitability provides a positive signal regarding a company's future prospects, encouraging greater investor confidence and increasing market valuation (Spence, 2002). Consequently, companies with stronger profitability are generally expected to exhibit better financial performance.

Previous empirical studies have consistently reported a positive relationship between profitability and financial performance. For instance, Jonnius and Marsudi (2021), Aydoğmuş et al. (2022), and Panjaitan and Supriati (2023) found that companies with higher profitability tend to achieve higher firm value because investors perceive strong earnings as an indication of sustainable growth and efficient management. However, several studies also reported insignificant relationships, suggesting that profitability may not always translate into higher market valuation under different market conditions.

Based on the theoretical arguments and previous empirical findings, the first hypothesis is formulated as follows:

H1: Profitability has a positive effect on financial performance.

Leverage and Financial Performance

Leverage reflects a company's financing strategy through the use of debt. From the perspective of Agency Theory, debt may serve as a monitoring mechanism that encourages managers to utilize corporate resources more efficiently. Nevertheless, excessive leverage may also increase financial obligations and financial risk, thereby influencing investors' perceptions of firm value (Jensen & Meckling, 1976). Therefore, the relationship between leverage and financial performance remains theoretically ambiguous.

Previous empirical findings also provide mixed evidence. Rajkumar (2014) and Akhtar et al. (2021) suggested that leverage may positively influence firm value by supporting investment and business expansion. In contrast, Sari and Witjaksono (2021) found that excessive leverage may reduce financial performance because investors perceive higher debt as an additional source of financial risk. These inconsistent findings indicate that the influence of leverage may depend on specific firm characteristics and market conditions.

Accordingly, the second hypothesis is proposed as follows:

H2: Leverage affects financial performance.

Index Inclusion and Financial Performance

The increasing importance of ESG has encouraged investors to consider sustainability-related information alongside financial indicators when evaluating firms. Companies included in

the IDX ESG Quality 45 Index are recognized as demonstrating relatively stronger ESG quality while maintaining favorable financial quality and market liquidity. As a result, these companies may receive different market valuations compared with companies that are not included in the index.

Previous studies have generally reported that firms with stronger ESG characteristics tend to achieve better market performance because investors associate ESG practices with lower business risk, stronger governance, and greater long-term sustainability (Aydoğmuş et al., 2022; Platsun et al., 2023). However, empirical evidence remains inconclusive, particularly within the Indonesian capital market and when ESG is represented by index inclusion rather than ESG scores or disclosure ratings.

Therefore, the following hypothesis is proposed:

H3: Financial performance differs between companies included and companies not included in the IDX ESG Quality 45 Index.

Profitability across Index Inclusion

Although profitability is generally expected to improve financial performance, investors may not respond equally to profitability across all companies. According to Signaling Theory, profitability provides a positive signal regarding corporate performance, while ESG-related characteristics provide additional information regarding sustainability and governance quality. Consequently, companies included in the IDX ESG Quality 45 Index may receive stronger market appreciation for higher profitability because profitability is supported by positive sustainability-related signals.

Most previous studies have focused on the direct effect of profitability on firm value. However, limited research has examined whether this relationship differs between companies included and companies not included in the IDX ESG Quality 45 Index. This study therefore extends the existing literature by investigating whether index inclusion distinguishes the relationship between profitability and financial performance.

Accordingly, the fourth hypothesis is formulated as follows:

H4: The relationship between profitability and financial performance differs between companies included and companies not included in the IDX ESG Quality 45 Index.

Leverage across Index Inclusion

The relationship between leverage and financial performance may also vary depending on a company's sustainability-related characteristics. Investors may perceive debt financing differently for companies demonstrating stronger governance and sustainability practices because these firms are generally considered more capable of managing financial risk and utilizing borrowed funds efficiently.

Despite extensive research on leverage and firm value, limited empirical evidence investigates whether index inclusion differentiates this relationship. Accordingly, this study examines whether companies included in the IDX ESG Quality 45 Index exhibit a different relationship between leverage and financial performance than companies outside the index.

Therefore, the final hypothesis is proposed as follows:

H5: The relationship between leverage and financial performance differs between companies included and companies not included in the IDX ESG Quality 45 Index.

METHOD

This study employs a quantitative research approach using secondary data to examine the effects of profitability and leverage on financial performance while comparing companies included and not included in the IDX ESG Quality 45 Index. The data were obtained from annual reports, audited financial statements, and market data published by the Indonesia Stock Exchange (IDX), company websites, and other publicly available financial databases. The study covers the 2019 - 2024 observation period and adopts a comparative research design. The population consists of companies listed on the Indonesia Stock Exchange (IDX), while the sample was selected using purposive sampling. The sample selection criteria are presented in Table 1.

Table 1. Sample Selection Criteria

No.	Sample Selection Criteria
1.	Companies listed on the Indonesia Stock Exchange (IDX) during the 2019–2024 observation period.
2.	Companies consistently included in or not included in the IDX ESG Quality 45 Index throughout the observation period.
3.	Companies publishing complete annual reports and audited financial statements for 2019 - 2024.

Based on these criteria, the final sample comprises 50 companies, consisting of 25 companies included and 25 companies not included in the IDX ESG Quality 45 Index, resulting in 300 firm-year observations. The list of sampled companies is presented in Table 2.

Table 2. Sample of Companies

No.	Included in IDX ESG Quality 45	Not Included in IDX ESG Quality 45
1.	Bank Central Asia	Bank CIMB Niaga
2.	Bank Rakyat Indonesia	Bank OCBC NISP
3.	Bank Mandiri	Bank Mega
4.	Bank Negara Indonesia	Bank BJB
5.	Indofood Sukses Makmur	Indosat Ooredoo Hutchison
6.	Indofood CBP	XL Axiata
7.	Unilever Indonesia	Tower Bersama Infrastructure
8.	Sumber Alfaria Trijaya	Nippon Indosari
9.	Mayora Indah	Ultrajaya Milk
10.	Sido Muncul	Dharma Satya Nusantara
11.	Aneka Tambang	Erajaya Swasembada
12.	Prodia Widyahusada	Medikaloka Hermina

13.	Bukit Asam	Sarana Meditama
14.	United Tractors	Mitra Keluarga Karyasehat
15.	Astra International	Astra Otoparts
16.	Telkom Indonesia	Gajah Tunggal
17.	Pakuwon Jati	Astra Argo Lestari
18.	Jasa Marga (Persero)	PP London Sumatra Indonesia
19.	Sarana Menara Nusantara	Japfa Comfeed Indonesia
20.	Selamat Sempurna	Charoen Pokphand Indonesia
21.	Aspirasi Hidup Indonesia	Malindo Feedmill
22.	Mitra Adiperkasa	Bumi Serpong Damai
23.	AKR Corporindo	Ciputra Development
24.	Semen Indonesia	Puradelta Lestari
25.	Kalbe Farma	Summarecon Agung

Financial performance is measured using Tobin's Q as the dependent variable, while profitability and leverage are measured using Return on Assets (ROA) and Debt-to-Equity Ratio (DER), respectively. Index inclusion is represented by a dummy variable, where a value of one indicates companies included in the IDX ESG Quality 45 Index and zero indicates companies not included in the index. To examine whether the relationships between profitability, leverage, and financial performance differ between the two groups, interaction terms between the index inclusion variable and each financial variable are incorporated into the regression model. The operational definitions of the research variables are summarized in Table 3.

Table 3. Variable Measurement

Variable	Measurement	Description
Financial Performance	Tobin's Q	Market value of equity + total liabilities / total assets
Profitability	ROA	Net income / total assets
Leverage	DER	Total liabilities / total equity
Index Inclusion	ESGQ	1 = Included, 0 = Not Included

The study applies a pooled Ordinary Least Squares (OLS) regression model with company-clustered robust standard errors and year fixed effects. Prior to estimating the regression model, descriptive statistics and classical assumption tests were conducted to ensure that the regression model satisfied the required statistical assumptions (Gujarati & Porter, 2009). Since the diagnostic tests indicated the presence of heteroskedasticity and autocorrelation, company-clustered robust standard errors were employed to obtain reliable statistical inference. Year fixed effects were also included to control for common macroeconomic conditions and time-specific events that may simultaneously influence all firms during the observation period. The regression model is specified as follows:

$$TobinQ_{it} = \beta0 + \beta1\ ROA_{it} + \beta2\ DER_{it} + \beta3\ ESGQ_{it} + \beta4(ESGQ_{it} \times ROA_{it}) + \beta5(ESGQ_{it} \times DER_{it}) + \delta\ YEAR_t + \varepsilon_{it}$$

RESULT AND DISCUSSION

Descriptive Statistics

Table 4. Descriptive Statistics Results

Variable	ESGQ	N	Mean	Std. Dev.	Min	Max
ROA	Not Included	150	0.0558	0.0507	-0.0512	0.1997
	Included	150	0.0955	0.0772	-0.0004	0.3580
	Overall	300	0.0756	0.0681	-0.0512	0.3580
DER	Not Included	150	1.9833	2.4151	0.1024	10.7230
	Included	150	1.7558	1.9007	0.1295	6.6260
	Overall	300	1.8696	2.1753	0.1024	10.7230
Tobin's Q	Not Included	150	1.4353	1.1193	0.5700	7.1100
	Included	150	2.1232	2.2046	0.4700	16.2600
	Overall	300	1.7792	1.7791	0.4700	16.2600

(Source: Data processed using Stata)

Table 4 presents the descriptive statistics of the research variables for companies included and not included in the IDX ESG Quality 45 Index. Companies included in the index report higher average profitability (ROA) and financial performance (Tobin's Q) than companies outside the index. In contrast, companies not included in the index exhibit a higher average Debt-to-Equity Ratio (DER), indicating greater reliance on debt financing. Overall, these descriptive results suggest that companies included in the IDX ESG Quality 45 Index tend to demonstrate stronger financial characteristics. However, descriptive statistics alone cannot determine whether these differences are statistically significant. Therefore, regression analysis is conducted to further examine the proposed hypotheses.

Classical Assumption Tests

Table 5. Classical Assumption Test Results

Test	Statistic	Results	Conclusion
Normality	$\chi^2 = 83.88$	p = 0.0000	Residuals are not normally distributed
Multicollinearity	Mean VIF = 2.91	-	No multicollinearity (VIF < 10)
Autocorrelation	F = 57.167	p = 0.0000	Autocorrelation detected

Heteroskedasticity	$\chi^2 = 498.03$	p = 0.0000	Heteroskedasticity detected

(Source: Data processed using Stata)

Prior to estimating the regression model, classical assumption tests were conducted to assess the validity of the regression model. The normality test indicates that the residuals are not normally distributed. However, this does not invalidate the OLS estimation. The multicollinearity test reports a mean Variance Inflation Factor (VIF) below the accepted threshold, indicating that multicollinearity is not a concern. In contrast, the heteroskedasticity and autocorrelation tests indicate violations of the classical assumptions. Therefore, the final regression model employs company-clustered robust standard errors, providing reliable statistical inference despite the presence of heteroskedasticity and autocorrelation.

Regression Results

Table 6. Regression Results

Variable	β	p-value	Result
ROA	12.2962	0.000	Significant
DER	-0.0054	0.765	Not Significant
ESGQ	-1.5849	0.000	Significant
ESGQ × ROA	12.2600	0.006	Significant
ESGQ × DER	0.3497	0.000	Significant

(Source: Data processed using Stata)

Table 6 presents the regression results estimated using pooled Ordinary Least Squares (OLS) with company-clustered robust standard errors and year fixed effects. The overall model is statistically significant, as indicated by the F-test ($p < 0.001$). Furthermore, the adjusted R^2 of 0.5846 indicates that approximately 58.46% of the variation in financial performance is explained by the independent variables included in the model.

Profitability (ROA) has a positive and statistically significant effect on financial performance, supporting H1. In contrast, leverage (DER) is not statistically significant for companies not included in the IDX ESG Quality 45 Index; therefore, H2 is not supported. The coefficient of ESGQ is statistically significant, indicating differences in financial performance between companies included and companies not included in the IDX ESG Quality 45 Index. Accordingly, H3 is supported. In addition, both interaction terms are positive and statistically significant, suggesting that the relationships between profitability, leverage, and financial performance differ according to index inclusion. Therefore, H4 and H5 are supported.

Profitability and Financial Performance

The findings indicate that profitability has a positive and significant effect on financial performance. This result supports Signaling Theory, which suggests that higher profitability provides a positive signal regarding a firm's operational efficiency and future growth prospects. Consequently, investors tend to assign higher market valuations to more profitable companies, resulting in higher Tobin's Q values. Companies with strong profitability are generally perceived as having better financial stability and greater capacity to generate future earnings, making them more attractive to investors. This finding is consistent with previous studies by Jonnius and

Marsudi (2021), Aydoğmuş et al. (2022), and Panjaitan and Supriati (2023), which reported that profitability positively influences firm value.

Leverage and Financial Performance

The findings indicate that leverage does not have a significant effect on financial performance among companies not included in the IDX ESG Quality 45 Index. This suggests that debt financing alone does not necessarily increase firm value, as investors also consider how effectively borrowed funds are utilized to support long-term performance. Companies with higher debt levels may be viewed as having greater financial obligations and risk, particularly when debt is not accompanied by efficient resource utilization or stronger future growth prospects. This finding is consistent with Sari and Witjaksono (2021), who reported that leverage does not always improve firm value because higher debt may also increase financial risk. From the perspective of Agency Theory, although debt may function as a monitoring mechanism, its effectiveness depends on how efficiently companies manage their financial resources.

Financial Performance across Index Inclusion

The significant coefficient of the index inclusion variable indicates that financial performance differs between companies included and companies not included in the IDX ESG Quality 45 Index. This finding suggests that index inclusion is associated with differences in market-based financial performance, reflecting that investors may respond differently to companies recognized for stronger ESG quality and financial fundamentals. One possible explanation is that companies included in the index are perceived as demonstrating stronger sustainability practices and governance quality, which may enhance investor confidence and market valuation. The result highlights the growing importance of sustainability-related characteristics in investment decision-making and the role of ESG-based classification within the Indonesian capital market. This finding is also consistent with previous studies suggesting that firms with stronger ESG characteristics tend to receive more favorable market responses (Aydoğmuş et al., 2022; Platsun et al., 2023).

Differences in Financial Relationship across Index Inclusion

The positive and significant interaction terms indicate that the relationships between profitability, leverage, and financial performance differ between companies included and companies not included in the IDX ESG Quality 45 Index. Specifically, the positive relationship between profitability and financial performance becomes stronger among companies included in the index. Similarly, although leverage is not significant for companies outside the index, the positive interaction effect suggests that debt financing is viewed more favorably for companies included in the index. These findings imply that investors do not evaluate financial indicators in isolation but also consider a company's sustainability-related characteristics when assessing firm value.

These findings support Signaling Theory, suggesting that strong financial performance combined with favorable ESG-related characteristics provides a stronger signal to investors. Companies included in the IDX ESG Quality 45 Index may therefore receive greater market appreciation because investors perceive profitability and financing decisions within the context of stronger ESG quality and corporate governance. Consequently, inclusion in the IDX ESG Quality 45 Index strengthens the association between corporate financial characteristics and market-based financial performance.

CONCLUSION

This study examines the effects of profitability and leverage on financial performance while comparing companies included and not included in the IDX ESG Quality 45 Index. The findings indicate that profitability has a positive and significant effect on financial performance, whereas leverage does not significantly affect financial performance among companies not included in the index. In addition, financial performance differs between companies included and not included in the IDX ESG Quality 45 Index. More importantly, the relationships between profitability, leverage, and financial performance also differ across the two groups, with profitability exhibiting a stronger positive relationship and leverage becoming positively associated with financial performance among companies included in the index. Overall, these findings suggest that index inclusion plays an important role in strengthening the relationship between corporate financial characteristics and market-based financial performance, thereby contributing to a better understanding of the role of ESG-related classification in the Indonesian capital market.

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