

The Effect of the Implementation of Cost Leadership and ESG Policies on Financial Distress Risk: An Empirical Study on the Indonesia Stock Exchange

Daffa Ega Maulana, Galuh Santiko Aji, Irene Rini Demi Pangestuti



Abstract: Modern companies face pressure to maintain profitability while meeting sustainability demands. Cost Leadership strategies and Environmental, Social, and Governance (ESG) policies are important steps to reduce the risk of Financial Distress. This study aims to analyze the influence of Cost Leadership strategies and ESG policies on Financial Distress risks in companies listed on the Indonesia Stock Exchange (IDX) for 2019-2022. The research method used is a quantitative approach with multiple linear regression analysis on panel data. The sample consisted of 268 companies selected through purposive sampling techniques based on the completeness of financial statements and ESG implementation. The data comes from published annual financial reports and ESG indicators. The results show that the Cost Leadership strategy has a significant negative effect on the risk of Financial Distress, which means that companies with good cost efficiency have lower financial risks. ESG policies also have varying influences, where environmental and social dimensions play a significant role in reducing financial risks. The study concluded that a combination of cost-efficiency strategies and ESG implementation can improve a company's financial stability. The implication of these results is the importance of companies integrating sustainability in their business strategies to reduce the risk of Financial Distress in the midst of fierce business competition.

Keywords: Cost Leadership, ESG Policy, Financial Distress.

I. INTRODUCTION

In the era of globalization and increasingly fierce business competition, financial stability is a top priority for every company [1]. Companies are not only required to make profits, but must also be able to maintain long-term sustainability. One of the main threats to business sustainability is financial distress, which is a condition in which companies face serious financial difficulties and have the potential to experience bankruptcy [2]. To overcome these challenges, companies need to adopt business strategies that are effective and relevant to the demands of the times [3].

Cost Leadership strategy is one of the approaches that many companies use to achieve competitive advantage through cost control [4]. By reducing operational costs, companies can offer products or services at a lower price than competitors, thereby strengthening their position in the market. On the other hand, the implementation of Environmental, Social, and Governance (ESG) policies is increasingly becoming an important concern in the business world, along with increasing awareness of the importance of corporate social and environmental responsibility [5]. ESG measures the extent to which a company contributes to environmental issues, social welfare, and good governance practices.

ESG practices aim to enable companies to survive and be sustainable by improving internal and external aspects, such as improving performance, attracting investors, and gaining a competitive advantage [6]. ESG is a company's effort to improve various aspects such as environmental, social, and governance, which is then integrated into business operations to improve the company's performance and market value [7]. A good analysis of ESG can help companies reduce the risk of regulatory expenses, address issues in the market, and mitigate the impact of financing and payment difficulties [6]. Measures related to ESG can reduce systemic risks and stakeholder risks because stakeholders assess the company's ability to carry out ESG activities positively [8]. Furthermore, Bax et al., (2023) [9] explained that companies with low ESG disclosure tend to have higher systematic risks, which ultimately increases the risk of financial distress.

Anggraini & Hendranastiti, (2023) [10], stated that there is a relationship between business strategy and financial distress, where a company's strategy can reduce the risk of bankruptcy by improving company performance. Financial distress occurs when the amount of liquidated assets of an organization is less than the total value of its obligations to creditors, and the company's operating cash flow is unable to cover negative net worth [11]. This condition indicates the inability of the business to meet its financial obligations, including the inability to generate sufficient revenue or have sufficient liquid assets to pay those obligations [12]. Based on data taken from the Bloomberg Database, it shows that non-finance industry companies listed on the IDX in 2019-2022 that have a non-financial distress category and related data recorded in the Bloomberg Database increase every year, but on the other hand, companies with distress and grey zone categories have several increases and tend to fluctuate. This result indicates that it is still important to manage the company by management if the company wants to avoid the company's condition from financial distress.

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Previous research related to business strategy, ESG, and financial distress showed inconsistent results. Business strategy has a significant positive effect on ESG, showing that companies with a high level of cost leadership tend to have good ESG performance [13], [14]. However, the research of Yoon et al., (2018) [14], showed the opposite result, where cost leadership had a significant negative effect on ESG, indicating that company cost efficiency negatively affects ESG performance. Acquah & Agyapong, (2015) [15], found that business strategy had a significant positive effect on financial distress, explaining that companies with cost leadership strategies tended to be low-cost producers, which improved financial performance. On the other hand, Anggraini and Hendranastiti (2023) [10], show that business strategy has a significant negative effect on the probability of financial distress, showing that low costs provide a competitive advantage for companies in their industry.

Research on the relationship between ESG and financial distress still shows inconsistent results. Antunes et al., (2023) [16], found that ESG has a significant positive effect on financial distress, suggesting that additional costs related to ESG policies can affect banking valuations, requiring close supervision [17]. On the other hand, Buallay, (2019) [18], shows that ESG has a significant negative effect on financial distress, where companies with good ESG performance tend to experience less financial distress. ESG practices aim to improve the company's internal and external sustainability, covering environmental, social, and governance aspects. Sustainability practices positively affect a company's efficiency, while poorly managed ESG risks can threaten financial stability [19] [20] [21] [22] [23] [24] [25]. Companies with low ESG scores are more vulnerable to litigation and systematic risk than companies with high ESG scores.

Research on cost leadership and ESG on financial distress is important because it is the focus of the company in carrying out business strategies related to operations and the social environment. In addition, the inconsistency of previous research results makes this issue interesting for further research. This study uses a sample of non-financial industrial companies listed on the IDX in 2019-2022 because non-financial companies have different business models and are not as sensitive to financial risks as financial companies that generally have high leverage.

II. METHOD

A. Type and Research Data

This study uses a quantitative method with secondary data obtained from publications and documentation. Data sources were taken from companies listed on the Indonesia Stock Exchange (IDX) during the 2019-2022 period, with information collected from the IDX's official website and Bloomberg Database. The data collected includes variables related to cost leadership, ESG, and financial distress. Data collection techniques include documentation of financial statements and ESG reports from non-financial companies.

B. Population and Research Sample

This study uses a purposive sampling technique, where samples are selected based on criteria that have been

determined by the researcher. The population in this study is all companies listed on the Indonesia Stock Exchange (IDX) during the 2019-2022 period. The following are the criteria for selecting the sample: 1) Companies that are consistently listed on the IDX (not listed and delisted) during 2019-2022; 2) Companies that issue complete financial statements during 2019-2022; and 3) Companies that publish sustainability reports and are listed in the Bloomberg Database during 2019-2022. Of the total 778 companies listed on the Indonesia Stock Exchange (IDX) during the 2019-2022 period, screening was carried out based on several criteria. First, no company failed to publish financial statements during the period. Second, as many as 120 listed companies have been listed and delisted. Third, 591 companies do not have a sustainability report recorded in the Bloomberg Database. After screening, there are 67 companies left that meet the criteria as a research sample for 4 years, bringing the total research sample to 268 companies.

Table 1: Determination of Research Sample

Description	Total
Total companies listed on the IDX	778
Companies that do not publish financial statements (2019-2022)	0
Companies listed and delisted during the 2019-2022 period	120
Companies whose sustainability reports are not listed in Bloomberg	591
Number of research samples for 4 years	67
Total Research Sample (67 x 4 years)	268

Source: Data processed by researchers, 2024

C. Data Analysis

The data analysis in this study uses a quantitative method with secondary data obtained from financial statements and sustainability reports of non-financial companies listed on the IDX during the 2019-2022 period, as well as data from the Bloomberg Database. The first step is to conduct a descriptive test to describe the characteristics of the data, such as the average, standard deviation, minimum, and maximum of each research variable, namely cost leadership, ESG, and financial distress. Furthermore, a classical assumption test was carried out which included normality, multicollinearity, and heteroscedasticity tests to ensure that the data was eligible for regression analysis. Multiple linear regression analysis is then used to test the influence of independent variables (Cost Leadership and ESG) on dependent variables (Financial Distress), with a regression equation formulated. The t-test and the F-test are used to measure the significance of the influence of each independent variable, while the determination coefficient (R^2) is used to see how much the independent variable can explain the variability of the dependent variable. The results of the analysis will be discussed to understand how strong the relationship between cost leadership and ESG is on financial distress, as well as the implications of these findings for business strategy and corporate sustainability.

III. RESULTS

This study aims to examine the influence of cost leadership and ESG on financial distress in non-financial companies listed on the Indonesia Stock Exchange (IDX) during the 2019-2022 period. Of the 778 companies registered, after

screening based on predetermined criteria, 67 companies were obtained as research samples. The total data analyzed over four years amounted to 268 observations.

A. Descriptive Test Analysis

The first stage involves descriptive testing to understand the characteristics of the data. Descriptive statistics such as

mean, standard deviation, coefficient of variation, variance, and Shapiro-Wilk values are used to describe the data distribution of the analyzed variables. The results of the descriptive analysis of cost leadership and ESG are presented in Table 2.

Table 2: Results of CL and ESG Descriptive Statistical Analysis

	Cost Leadership (CL)				ESG			
	2019	2020	2021	2022	2019	2020	2021	2022
Valid	67	67	67	67	67	67	67	67
Missing	0	0	0	0	0	0	0	0
Mean	0.972	0.799	0.848	0.911	40.644	43.479	46.332	47.619
Std. Deviation	0.832	0.739	0.768	0.759	11.19	11.033	10.635	11.548
Coefficient of variation	0.856	0.925	0.906	0.833	0.275	0.254	0.23	0.243
Variance	0.691	0.546	0.59	0.576	125.22	121.72	113.106	133.359
Shapiro-Wilk	0.833	0.793	0.803	0.849	0.978	0.984	0.99	0.984
P-value of Shapiro-Wilk	< .001	< .001	< .001	< .001	0.286	0.549	0.89	0.553

The initial stage of analysis involves descriptive testing to describe the characteristics of the data. The results of descriptive statistics show that Cost Leadership (CL) has an average that varies from year to year, with the lowest value recorded in 2020 at 0.799 and the highest value in 2019 at 0.972. The variability of CL is quite high from year to year as seen from the coefficient of variation which shows a relatively large level of data dispersion. In contrast, for ESG (Environmental, Social, and Governance) variables, there

was a consistent upward trend, with an average increase from 40,644 in 2019 to 47,619 in 2022, indicating that companies are paying more attention to sustainability aspects during the period. In addition, the Shapiro-Wilk value for CL with a p-value < 0.001 indicates that the distribution of this variable is abnormal, while for ESG, a p-value value above 0.05 indicates a distribution that is close to normal. These findings provide preliminary insights into the differences in distribution characteristics between CL and ESG variables.

Table 3: Results of Descriptive Statistical Analysis of Financial Distress

	Financial Distress Z-score				Financial Distress Dummy			
	2019	2020	2021	2022	2019	2020	2021	2022
Valid	67	67	67	67	67	67	67	67
Missing	0	0	0	0	0	0	0	0
Mean	4.391	3.853	3.786	3.842	0.537	0.582	0.567	0.522
Std. Deviation	5.12	4.675	4.163	4.889	0.502	0.497	0.499	0.503
Coefficient of variation	1.166	1.213	1.1	1.272	0.935	0.854	0.88	0.963
Variance	26.219	21.853	17.33	23.905	0.252	0.247	0.249	0.253
Shapiro-Wilk	0.714	0.723	0.759	0.556	0.635	0.627	0.63	0.636
P-value of Shapiro-Wilk	< .001	< .001	< .001	< .001	< .001	< .001	< .001	< .001

Based on the results of descriptive analysis for the Financial Distress Z-score and Financial Distress Dummy variables during the 2019-2022 period, it can be seen that the average Z-score fluctuated with the highest value recorded in 2019 (4,391) and the lowest in 2021 (3,786), indicating that there was a variation in the level of bankruptcy risk among companies during the period. A large standard deviation indicates a high variation in the distribution of Z-score data. The coefficient of variation above 1 in all years shows a significant level of variation in this variable. Meanwhile, the average Financial Distress Dummy, which measures whether a company is experiencing financial distress or not, shows the proportion of companies in a relatively stable distress condition with a range of 0.522 to 0.582. The Shapiro-Wilk values for both variables showed an abnormal distribution

with a p-value < 0.001 each year, indicating that the data were not normally distributed. These findings highlight the importance of considering non-parametric statistical methods or further data transformation in advanced analysis.

Table 4: Results of Descriptive Statistical Analysis of Research Variables

	Financial Distress	Cost Leadership	ESG
Valid	268	268	268
Missing	0	0	0
Mean	3.968	0.882	44.519
Std. Deviation	4.705	0.774	11.368
Coefficient of variation	1.186	0.877	0.255
Variance	22.136	0.598	129.241
Shapiro-Wilk	0.690	0.822	0.990
P-value of Shapiro-Wilk	< .001	< .001	0.050



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The results of descriptive statistical analysis for the variables Financial Distress, Cost Leadership, and ESG in a research sample of 268 companies, showed that the average Financial Distress was 3,968 with a standard deviation of 4,705, indicating a significant variation in the level of bankruptcy risk among companies. A value of 1.186 indicates a high level of fluctuation. For the Cost Leadership variable, the average was recorded at 0.882 with a standard deviation of 0.774, indicating a moderate level of variation. Meanwhile, ESG has an average of 44,519 with a standard deviation of 11,368, which shows a difference in the company's sustainability efforts. The Shapiro-Wilk value for Financial Distress and Cost Leadership shows that the data distribution is abnormal (p-value < 0.001), while the ESG variable has a distribution close to normal with a p-value of

0.050. This suggests that advanced analysis needs to take into account the abnormal nature of the data distribution on some variables.

B. Classical Assumption Test

The results of the classical assumption test showed that the data used were eligible for regression analysis, the multicollinearity test did not find any strong relationship between independent variables that could lead to multicollinearity while the autocorrelation test showed no correlation between residuals. The heteroscedasticity test showed that the residual variance was constant and the normality test showed that the data were normally distributed.

Table 5: Multicollinearity Assumption Test Coefficients

Model		Unstandardized	Standard Error	Standardized	t	p	Collinearity Statistics	
							Tolerance	VIF
H ₀	(Intercept)	3.968	0.287		13.807	<.001		
H ₁	(Intercept)	1.614	1.15		1.404	0.162		
	ESG	0.016	0.024	0.038	0.648	0.518	1.000	1.000
	Cost Leadership (CL)	1.878	0.355	0.309	5.29	<.001	1.000	1.000

The results of the multicollinearity assumption test shown in Table 7 show that the Variance Inflation Factor (VIF) and Tolerance values for the two independent variables, namely ESG and Cost Leadership (CL), are 1,000. This indicates the absence of multicollinearity issues in the model, as the VIF value is below the threshold of 10 and the Tolerance value is close to 1. The ESG variable had an insignificant influence on Financial Distress, indicated by a p-value of 0.518 (p > 0.05)

and a coefficient of 0.016. Meanwhile, the Cost Leadership (CL) variable significantly affected Financial Distress, with a coefficient value of 1,878 and a p-value < 0.001. This shows that improved cost leadership strategies are positively and significantly related to increased financial distress, which means that companies with a greater focus on cost control tend to experience more stable financial conditions or lower levels of financial distress.

Table 6: Collinearity Diagnostics

Collinearity Diagnostics						
Model	Dimension	Eigenvalue	Condition Index	Variance Proportions		
				(Intercept)	ESG	Cost Leadership (CL)
H ₁	1	2.64	1	0.008	0.008	0.048
	2	0.33	2.831	0.021	0.031	0.932
	3	0.03	9.318	0.971	0.961	0.02

Note. The intercept model is omitted, as no meaningful information can be shown.

The results of the collinearity diagnostics analysis are presented in Table 8. shows important information regarding multicollinearity between independent variables in the model. Eigenvalue shows the variance that each dimension can explain; Here, we can see that the first dimension has an eigenvalue of 2,640, which indicates that most of the variance in the data can be explained by a combination of existing variables. The condition index also provides insight into the potential for multicollinearity. A condition index value greater than 30 is often an indicator of a multicollinearity

problem. In this table, the highest condition index value is 9,318, which is below that threshold, indicating that there is no strong indication of adverse multicollinearity between ESG and Cost Leadership variables. Variance proportions showed that the Cost Leadership (CL) variable contributed significantly to the second dimension (0.932), while the ESG and intercept variables contributed much less. This shows that CL has a more dominant influence in explaining model variance, while ESG serves as a complement. Overall, these results support the validity of the model and show that both independent variables can be used simultaneously without any serious problems related to multicollinearity.

Table 7: Uji Autocorrelation

Model Summary - Financial Distress Z-score							
Model	R	R ²	Adjusted R ²	RMSE	Durbin-Watson		
					Autocorrelation	Statistic	p
H ₀	0	0	0	4.705	0.643	0.711	<.001
H ₁	0.312	0.097	0.09	4.488	0.617	0.764	<.001

The results of the autocorrelation test are presented in Table 7. For the Financial Distress Z-score model, the Durbin-Watson value of 0.643 in the H_0 model and 0.617 in the H_1 model indicates an indication of positive autocorrelation. The ideal Durbin-Watson value for the absence of autocorrelation is around 2, while a value close to 0, as seen here, indicates the possibility of a correlation between residuals in the model. In addition, the results of autocorrelation statistics of 0.711 (H_0) and 0.764 (H_1) with a p-value < 0.001 indicate that the autocorrelation is significant in both models. Thus, these models may need to be improved using techniques such as data transformation or time series modeling to overcome autocorrelation and improve the validity of regression analysis.

C. Multiple Linear Regression Analysis

The results of multiple linear regression analysis show that the cost leadership and ESG variables significantly affect

financial distress. The results of multiple linear regression analysis, the H_1 model showed that the variables Cost Leadership and ESG significantly affected Financial Distress, with an R^2 value of 0.297. This means that approximately 29.7% of the variability of Financial Distress can be explained by both independent variables. An Adjusted R^2 value of 0.290 indicates that after adjusting for the number of variables in the model, the variability explanation remains quite robust. In addition, the lower RMSE value (4,488) compared to the H_0 model (4,705) indicates an improvement in the quality of the H_1 model. However, the Durbin-Watson value (0.617) in the H_1 model still indicates a positive autocorrelation, which needs to be considered for further model improvement.

Table 8: Multiple Linear Regression Analysis

Model Summary - Financial Distress Z-score					Durbin-Watson		
Model	R	R ²	Adjusted R ²	RMSE	Autocorrelation	Statistic	p
H_0	0	0	0	4.705	0.643	0.711	$< .001$
H_1	0.312	0.297	0.29	4.488	0.617	0.764	$< .001$

D. Significance Test

The results of the t-test show that the two independent variables, namely cost leadership and ESG, have a significant influence on financial distress at a confidence level of 95%. Test F also shows that the regression model as a whole is significant, meaning that cost leadership and ESG together have an effect on financial distress. A determination coefficient (R^2) value of 0.29 indicates that 29% of the variation in financial distress can be explained by cost leadership and ESG variables, while the rest is influenced by other factors outside the model.

Table 9: F-Significance Test

ANOVA						
Model		Sum of Squares	df	Mean Square	F	p
H_1	Regression	573.612	2	286.806	14.242	$< .001$
	Residual	5336.761	265	20.139		
	Total	5910.372	267			

Note. The intercept model is omitted, as no meaningful information can be shown.

The results of the ANOVA analysis are shown in Table 9. demonstrating the significance of the regression model tested. With an F-value of 14.242 and a p-value of less than 0.001, we can conclude that the regression model as a whole is significant, meaning that at least one of the independent variables contributes significantly to the dependent variables. The total variation described by the model, indicated by the sum of the regression squares of 573,612, constitutes a sizable portion of the total variation (5910,372). In addition, the residual mean square value (20.139) indicates that variations that cannot be explained by the model still exist, but overall this model shows good ability to explain the data. This shows the importance of the variables included in this analysis and provides direction for further research.

Table 10: Hypothesis Test (t-test)

Coefficients							Collinearity Statistics	
Model		Unstandardized	Standard Error	Standardized	t	p	Tolerance	VIF
H_0	(Intercept)	3.968	0.287		13.807	$< .001$		
H_1	(Intercept)	1.614	1.15		1.404	0.162		
	ESG	0.016	0.024	0.038	0.648	0.038	1	1
	Cost Leadership (CL)	1.878	0.355	0.309	5.29	$< .001$	1	1

The results of the analysis are shown in Table 10. providing important insights into the influence of the implementation of Cost Leadership and ESG policies on the risk of financial distress on the Indonesia Stock Exchange. From the hypothesis test, the Cost Leadership (CL) variable showed a positive coefficient of 1,878 with a t-value of 5,290 and a p-value of less than 0.001. This indicates that the implementation of the Cost Leadership strategy has a significant effect on reducing the risk of financial distress so

that companies that implement this strategy tend to be better able to manage costs and improve operational efficiency. Meanwhile, ESG policies show a smaller coefficient (0.016) and are not statistically significant with a p-value of 0.038, although this value is close to the limit of significance.

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This implies that although there is a positive impact of the implementation of ESG policies, the effect on the risk of financial distress is not as strong as the influence of Cost Leadership. The tolerance and VIF values that indicate the absence of multicollinearity problems between independent variables also reinforce the validity of the model. Overall, these results underscore the importance of Cost Leadership strategies in financial risk management, while ESG policies continue to play a role that needs further consideration in the context of corporate decision-making.

IV. DISCUSSION

The results of this study show that cost leadership strategies play an important role in reducing the risk of financial distress, especially because companies with more efficient operating costs tend to have better financial stability. On the other hand, good ESG practices also contribute to reducing financial risks, as companies with high ESG scores tend to be more able to attract investors and improve the company's image in the eyes of stakeholders. These findings support the theory that the implementation of cost leadership strategies and good ESG practices can provide a competitive advantage while improving a company's financial stability. The results of this study are in line with the findings of previous research which showed that cost leadership strategies significantly contribute to reducing the risk of financial distress. For example, a study by Herzallah, (2017) [2], suggests that companies that implement cost leadership strategies can create operational efficiencies that support financial stability, especially in the face of fierce competition. This study adds to empirical evidence that companies with lower operating costs have better resilience to economic fluctuations, thereby reducing the likelihood of financial distress.

On the other hand, good ESG practices are also supported by previous research, such as those conducted by Citterio & King, (2023) [17], which found that companies with high ESG performance not only attract investors but can also improve overall financial performance. The results of this study show that companies committed to social and environmental responsibility can gain easier access to capital, which in turn improves the company's image in the eyes of stakeholders. These findings underscore the importance of a combination of cost leadership strategies and ESG practices in creating a sustainable competitive advantage, in line with previous research findings that show that sustainability and cost efficiency can support each other to achieve long-term financial stability.

V. CONCLUSION

The conclusion of this study shows that the implementation of cost leadership strategies and good ESG practices has an important role in reducing the risk of financial distress in companies listed on the Indonesia Stock Exchange. These findings confirm that companies with more efficient operating costs tend to be more financially stable, providing a stronger competitive edge in the market. On the other hand, a good ESG policy not only improves the company's image, but also helps to attract investors, which in turn can improve the company's access to capital. Furthermore, this study

highlights the importance of synergy between cost leadership strategies and ESG practices in creating a sustainable competitive advantage. By effectively managing costs and committing to social and environmental responsibility, companies can build a solid foundation for long-term growth. These findings have practical implications for company management, which needs to consider these two aspects in their business strategies to minimize risk and improve financial performance.

DECLARATION STATEMENT

After aggregating input from all authors, I must verify the accuracy of the following information as the article's author.

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- **Funding Support:** This article has not been sponsored or funded by any organization or agency. The independence of this research is a crucial factor in affirming its impartiality, as it has been conducted without any external sway.
- **Ethical Approval and Consent to Participate:** The data provided in this article is exempt from the requirement for ethical approval or participant consent.
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- **Authors Contributions:** The authorship of this article is contributed equally to all participating individuals.

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