CHAPTER 1

INTRODUCTION

1.1 Background

In 2020, Indonesia was officially appointed to host the presidency of the G20 Summit in 2022, with one of its priority agendas namely implementing sustainability in the economy which can also be called a green economy (Bank Indonesia, 2022). The topics of discussion are related to climate risk and the risk of the transition to a low-carbon economy, and sustainable finance from a macroeconomic and financial stability point of view (Bank Indonesia, 2022). This will affect the company's financial performance. A company's financial performance can be interpreted as the results achieved by the company's management in carrying out its function in managing company assets to find out and evaluate the company's success rate based on the financial activities carried out (Rudianto, 2013).

A company's financial performance is formed from the existence of policies continuously determined by the company's management. These policies are expected to achieve the company's goals more effectively and efficiently, which can be seen in the increase or improvement of the company's financial performance. The company's financial performance is important to maintain, especially at this time; business competition is increasing, which makes companies compete to maximize their performance. Over time, in determining a company policy, managers must not only focus on the company's financial goals but also need policies that consider social

and environmental interests. The company has responsibility for the positive and negative impacts on the economic, social, and environmental aspects. The right policies will help the company to occupy a more stable business position. The reason is, currently, many stakeholders consider environmental aspects in the operational activities of a company.

In 2015, Indonesia was declared the fourth largest country in the world that produces greenhouse gas emissions due to deforestation practices, peat forest fires, and emissions from fossil fuels or energy (Dunne, 2019). In 2016 it began to show its seriousness in committing to reduce the resulting emissions. This commitment is shown by Indonesia ratifying the Paris Agreement in 2016, which is an agreement in the United Nations Frameworks Convention on Climate Change (UNFCCC) which states that Through the Paris Agreement, Indonesia is implementing climate change mitigation commitments by planning to reduce emissions by 29% - 41% by 2030 for each production sector. (Ministry of Environment and Forestry, 2016).

One of the goals to be achieved through the Paris Agreement is to create consistent financial flows for the achievement of development that is low in greenhouse gas emissions and is resistant to climate change (Financial Services Authority, 2017). Meanwhile, the holding of COP26 on October 31, 2021, to November 12, 2021, is a new opportunity to improve the green economy to suppress the rate of global warming (Pratama, 2021). The COP26 meeting discussed one of the important issues related to climate change,

namely the promise of funding for developing countries to transition to energy, deforestation, and the sea (Utomo, 2021).

In addition, COP26 also held an online meeting with the Ministry of Environment and Forestry, confirming that the second Nationally Determined Contribution (NDC) would maintain its emission reduction target of 29%-41% by 2030 and slowly minimize coal consumption by 60% by 2030. the year 2050 will continue to a zero net emission condition in 2070 (Ministry of Environment and Forestry, 2021). In the second Nationally Determined Contribution (NDC), Indonesia added a new subject to strengthen its commitment by adding the subject of seas, wetlands, and human settlement areas (Ministry of Environment and Forestry, 2021). Then, based on a survey conducted by the Katadata Insight Center (KIC) entitled "Katadata Consumer Survey on Sustainability" stated that currently, consumers in Indonesia are willing to buy sustainable products even though they have to pay more, with the level of a consumer agreement to pay more reaching 6, 54 out of a scale of 10 (Alika, 2021). Therefore, managers can implement policies by adopting environmentally friendly economic practices that can contribute to climate change and minimize greenhouse gas emissions by conducting green innovation.

According to Damas et al. (2021), Green Innovation is energy efficiency, pollution reduction, waste recycling, and product design created from techniques or modifications in production processes to reduce the impact of environmental damage. In practice, applying green innovation

consists of green product innovation and process innovation. According to Salvado et al. (2013), green process innovation is a new process created because of modifications that aim to reduce the environmental impact on the company's business operational processes consisting of deployment and development that will affect the process and final results. The application of green process innovation benefits the company because it can minimize the decrease in the company's manufacturing burden with the efficiency of the burden that comes from un environmentally friendly activities.

The company's financial performance will improve if it implements green product innovation. According to Salvado et al. (2013) define green product innovation as an innovation that affects product design to reduce environmental impacts during the production process, the period of use, and until the end of a product's life. Investment in environmentally friendly product innovations can provide new market opportunities for companies. This will affect the purchase growth opportunities to improve the company's financial performance.

The factors that affect financial performance in this study, namely green process innovation and green product innovation, have been used and tested in previous studies. Research by Wang et al. (2021) shows that green process innovation positively affects green product innovation because it provides auxiliary elements such as capital, technology, management experience, and human capital. Green processes and product innovation positively affect the company's economic performance directly and indirectly.

Green process innovation has a direct effect, while green product innovation indirectly increases the company's environmental performance and market competitiveness.

Research by Ar (2012) shows that green product innovation positively affects firm performance and competitive capability. In addition, the managerial environmental concern can moderate the relationship between green product innovation and firm performance. Then, managerial environmental concern is not able to moderate the relationship between green product innovation and competitive capability.

Meanwhile, research conducted by Xie et al. (2019) shows that green process innovation, which is divided into clean technologies and end-of-pipe technologies, has a positive effect on financial performance. This study also states that industry differences and economic size have no effect on financial performance, financial constraints have a negative effect on financial performance, and environmental munificence and a firm number have a positive effect on financial performance. In this study, firm size, total asset turnover, and firm age positively affect corporate financial performance, but financial constraints negatively affect corporate financial performance.

The existence of previous studies that tested companies abroad motivated researchers to conduct tests on the Indonesia Stock Exchange. The objects used in this study are manufacturing sector companies listed on the Indonesia Stock Exchange in 2016-2021. Manufacturing sector companies are the largest sector in supporting the Indonesian economy, where the

manufacturing sector itself has the main activity to producing an item that can cause pollution due to the production activities carried out. The Ministry of Environment and Forestry stated that the manufacturing sector produces the most pollution, which illustrates the need to carry out responsibilities by innovating business processes as a form of environmental compliance (Nurcaya, 2020). In addition, the Ministry of Industry states that the manufacturing sector needs to implement a green industry in its business (Ministry of Industry of the Republic of Indonesia, 2017). The phenomenon of awareness of environmental compliance concerning the company's business operations and the lack of research that examines green process innovation and green product innovation in Indonesia is the motivation for this research.

1.2 Research Question

Manufacturing sector companies are the largest sector in supporting the Indonesian economy, where the manufacturing sector itself has the main activity to producing an item that can cause pollution due to the production activities carried out. The Ministry of Environment and Forestry stated that the manufacturing sector produces the most significant pollution, which illustrates the need to carry out social and environmental responsibility by innovating business processes as a form of environmental compliance (Nurcaya, 2020). In line with this, in 2016, Indonesia began to show its seriousness in being able to commit to reducing the resulting emissions. This

commitment is stated in the Paris Agreement (Financial Services Authority, 2017).

Through the Paris Agreement, Indonesia is committed to reducing its emissions by 29%-41% by 2030 against every business scenario in Indonesia (Dunne, 2019). It aims to form financial flows to achieve development that is low in greenhouse gas emissions and resistant to climate change (Financial Services Authority, 2017). In addition, there was a COP26 meeting that discussed promises related to funding for developing countries to make the transition to energy, deforestation, and the sea (Utomo, 2021). Then, based on a survey conducted by the Katadata Insight Centre (KIC), it was stated that consumers in Indonesia are currently willing to buy sustainable products even though they must pay more (Alika, 2021). Based on this, the formulation of the problem in the study is as follows:

1. Does green process innovation affect the financial performance of manufacturing sector companies listed on the Indonesia Stock Exchange in 2016-2021?
2. Does green product innovation affect the financial performance of manufacturing sector companies listed on the Indonesia Stock Exchange in 2016-2021?

1.3 Research Objectives

This study aims to re-examine and empirically prove the effect of green process innovation and green product innovation on the company's financial performance. In addition, re-testing was carried out on manufacturing sector companies listed on the Indonesia Stock Exchange with a more recent period, namely 2016-2021 so that the research results were more relevant.

1.4 Research Contributions

1. Theory Contributions

   This research is expected to be a source of reference for subsequent researchers regarding the effect of green process innovation and green product innovation on company financial performance and can be a complement to subsequent similar research.

2. Practice Contribution

   This research is expected to be useful for manufacturing sector companies listed on the Indonesia Stock Exchange to see the level of stability of the company's financial performance by considering green process innovation and green product innovation.

1.5 Research Limitations

Limitations in this study are:

1. The research was conducted using manufacturing sector companies listed on the Indonesia Stock Exchange.

2. This research uses annual reports or reports published by the Indonesia Stock Exchange for 2016-2021

1.6 Data Analysis

The stages of data analysis used in this study are described as follows:

1. Data Collection

   This study uses secondary data, where data collection is carried out regarding the variables in the study, namely green process innovation, green product innovation, and company financial performance which can be obtained from the annual reports of manufacturing sector companies listed on the Indonesia Stock Exchange in 2016-2021.

2. Data Analysis Tool

   Perform calculations related to research variables, namely the company's financial performance as the dependent variable and green process innovation and green product innovation as independent variables.

3. Hypothesis test

   After all data is collected and calculated using the measurement of each variable, the next step is to test the hypothesis. Hypothesis testing begins with conducting a preliminary test consisting of classic assumption tests and descriptive statistics. The classic assumption test was carried out using the normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test. Then, hypothesis testing

is carried out using the t-value test, model feasibility test, and coefficient of determination test. After testing the hypothesis, interpretation and analysis of the statistical test results are carried out.

1.7 Discussion Systematic

In this study there are five chapters consisting of:

CHAPTER 1 INTRODUCTION

It consists of research background, problem formulation, research objectives, research benefits, research limitations, data analysis, and writing systematics.

CHAPTER 2 LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

It consists of stakeholder theory, legitimacy theory, resource-based view theory, financial performance, green process innovation, green product innovation, previous research, and hypothesis development.

CHAPTER 3 RESEARCH METHOD

It consists of an explanation of the types of research, research objects, samples, operationalization and measurement of variables, research models, types of data and data collection techniques, and data analysis.

CHAPTER 4 ANALYSIS AND DISCUSSION

Describes an explanation of data analysis and the results of the discussion.

CHAPTER 5 CONCLUSION AND LIMITIATION

Consists of conclusions, research limitations and suggestions for further research.