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The Influence of Environmental Social and Governance (ESG) on the Financial Performance of Banking Companies Listed on the Indonesian Stock Exchange (BEI)

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Abstract---*The purpose of this study is to obtain empirical evidence of the Environmental Social and Governance (ESG) on the Banking Company firm's performance listed on the Indonesia Stock Exchange. The sampling technique used purposive sampling, the research samples obtained totaled 9 companies with a research period from 2019-2022 so there were 36 units of analysis. The research design was quantitative descriptive. The analysis technique in this research is the multiple regression analysis method. The results showed that the environmental has a significant positive effect, Governance and Social have no significant effect on a firm's performance. This research implies that companies must pay attention to Environmental Social and Governance and those that can affect profitability so that company performance can increase.*
Keywords---*Environmental, ESG, Governance, ROA, Social.*

Introduction

ESG (*Environmental, Social, and Governance*) has grown rapidly in the world. Many countries have implemented ESG factors in their investments. In Indonesia, especially in the banking world, the implementation of ESG has been implemented since 2009 with the inclusion of these criteria in banking financial statements, although until now, not all banks in Indonesia have implemented ESG. Financial performance is a metric in assessing the level of success of a company from the financial side of the company in a certain period in terms of funding aspects. To predict the quality of future production from existing resources, financial performance information is needed that can help assess potential changes in economic resources (Sundjaja & Berlian, 2011: Sundjaja & Berlian, 2003).

Potential investors should focus on company performance, as it plays an important role in assessing the financial condition of a company. This assessment helps investors to identify companies that generate higher profits compared to others. As a result, investors can make informed decisions about investing their money appropriately. One indicator of financial performance assessment can be done through the *Return on Assets* (ROA) ratio by comparing the value of net profit to the value of total assets (Utami & Muslih, 2022). In realizing sustainable financial planning,

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the application of *Environmental, Social, and Governance* (ESG) is required. The latest data from the *Global Reporting Initiative* (GRI) and the Indonesia Stock Exchange (IDX) shows that as of April 23, 2019, only 110 of the total 629 companies listed on the Indonesia Stock Exchange have submitted sustainability reports. This is also supported by Financial Services Authority Regulation No. 51/POJK.03/2017 concerning the implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies. Currently, financial sector companies are increasing in number and their development is also increasing based on good performance prospects. This can be seen from the average ROA value which is positive from 2019 to 2021.

This can be interpreted that from 2019 to 2021 the average financial sector company can provide net profit per rupiah of 6%, 3%, and 4%, respectively. Based on data from the Central Statistics Agency (BPS), non-financial sector companies are companies that have a high contribution of 57% to Indonesia's Gross Domestic Product (GDP) compared to the financial sector. The expansion of the financial sector can have environmental, social and governance impacts. It can lead to increased industrial activity and resource use (Melnyk et al., 2003; Brouwer, 2000).

Implementing *Environmental, Social, Governance* (ESG) practices such as emissions reduction, energy efficiency, and waste management, can help reduce these impacts (Alkaraan et al., 2022; Tsang et al., 2023). However, negative impacts can include human rights violations, poor working conditions, and conflicts with local communities. As such, the sector also faces challenges in corporate governance, such as ownership structure, board composition and internal control systems. As such, strong governance practices are needed to help companies operate ethically. All these components are necessary for the non-financial sector to achieve sustainable financial results (Ståhl et al., 2001).

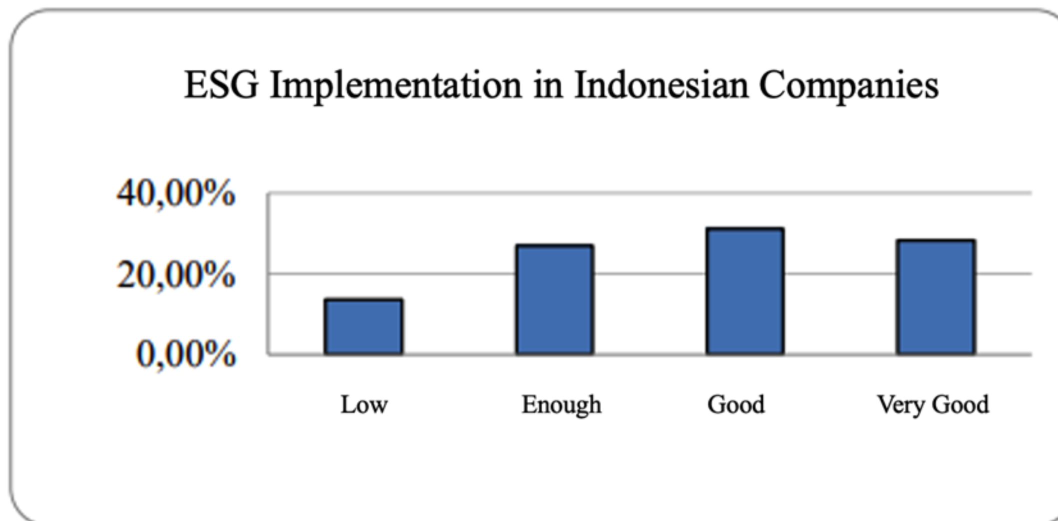

Chart 1. ESG Implementation in Indonesian Companies
Source: CRMS Indonesia (data processed in 2019)

The ESG-based investment in question is an investment that does not only pay attention to financial metrics in making investment decisions but also pays attention to ESG factors as non-financial factors. ESG or "*Environmental, Social and Governance*" itself is a set of standards that refer to three main criteria in measuring aspects of sustainability (Coles et al., 2001; Gradstein, 2004; Royhaan et al., 2022). This term is often used in the business world as a metric used in making decisions to invest in certain entities and also becomes a reference for reporting categories on the impact of a company's business activities. ESG factors are important to consider to take into account the risk factors, sustainability and growth potential of the company to be invested in. With increasingly critical issues such as climate change, *ethical supply chains*, natural resource degradation, and global welfare, ESG aspects are increasingly taking center stage as investors, regulators, and other interested parties seek to conduct business activities that positively contribute to solving these problems. (Riau, 2023).

Then, based on the ESG National Survey conducted by the *Center for Risk Management & Sustainability* (CRMS) in 2019 to gain an understanding of the practical conditions of ESG implementation in Indonesia, there are still companies whose ESG implementation is not good enough and can even be said to be lacking (Indonesia, 2019).

Previously, there have been studies that investigate the impact of ESG factor integration on financial performance but show inconsistent results. Such as the results of research conducted by Maftuchah (2018); Triyani et al. (2020); and Naeem et al. (2022) stated that the *Environmental has a* positive effect on Financial Performance. Meanwhile, research conducted by Hakimah et al. (2019); Şeker & Güngör (2022); Johan & Toti (2022); states that *Environmental has a* negative effect on Financial Performance. Hutasoit & Sembiring (2020); Nugroho & Hersugondo (2022); Ihsani et al. (2023); Rizqi (2023); argue that *Environmental has* no effect on Financial Performance.

Research conducted by Ghazali & Zulmaita (2020); Hutasoit & Sembiring (2020); Zaman & Ellili (2022); Rizqi (2023); states that *Social has a* positive effect on Financial Performance. Meanwhile, research conducted by; and Zahroh & Hersugondo (2021); Nugroho & Hersugondo (2022); Setiani (2023); Putri & Puspawati (2023); argue that *Social has* a negative effect on Financial Performance. Ihsani et al. (2023); Putri & Puspawati (2023); argue that *Social has* no effect on Financial Performance.

Research conducted by Hutasoit & Sembiring (2020); Trisnowati et al. (2022); Johan & Toti (2022); Setiani (2023); states that *Governance has a* positive effect on Financial Performance. Meanwhile, research conducted by Sunday et al. (2023); Priandhana (2022); Setiani (2023); argue that *Governance has* a negative effect on Financial Performance. Nugroho & Hersugondo (2022); Ihsani et al. (2023); Putri & Puspawati (2023); argue that *Governance* has no effect on Financial Performance.

The research gap in this study is based on the inconsistency of the influence of *Environmental, Social*, and *Governance* on Financial Performance carried out by previous researchers (Shakil, 2021). Therefore, this study tries to find out and review whether there is a significant influence. This research was conducted on banking sector companies listed on the Indonesia Stock Exchange because there are complete annual financial reports. Based on the background above, the authors are interested in taking the title in writing this thesis, namely *"The Effect of ESG on the Financial Performance of Banking Companies Listed on the Indonesia Stock Exchange (BEI)"*.

Research Methods

The object research was conducted at Banking Companies listed on the Indonesia Stock Exchange for the period 2018-2021. Data collection using a *purposive sampling* technique where a research sample of 9 companies was obtained. The research method used is a descriptive method with a quantitative approach using multiple regression analysis. The classical assumption test is carried out before the hypothesis test so that the test results meet the BLUE (Best Linear Unbiased Estimated) criteria. After that, hypothesis testing is carried out with the t-statistical test, F test, and coefficient of determination analysis. The model used in this study can be formulated as follows:

$$\boldsymbol{Y} = \boldsymbol{\alpha} + \boldsymbol{\beta 1 X}1 + \boldsymbol{\beta 2 X}2 + \boldsymbol{\beta 3 X} + \boldsymbol{\varepsilon}$$

Table 1
Operational Definition and Measurement of Variables

No.	Variables	Definition	Formula	Scale
1.	Environmental $(X)_1$	A company is related to its efforts in creating a conducive environment by prioritizing its operational activities towards environmental protection and the negative impacts resulting from these activities (Kristiani & Werastuti, 2020).	EnDI= (Σ Environmental Disclosure Items)/(Σ Disclosure Items)	Ratio
2.	Social $(X)_2$	The company carries out a practice known as social as a form of its commitment to uphold certain social responsibilities towards the local community (Kristiani & Werastuti, 2020).	*SoDI=(Σ Disclosure of Social Items)/(Σ Disclosure Items)*	Ratio
3.	Governance $(X)_3$	Manage stakeholders, managers, the company, creditors, government and employees. Thus, a well-managed company will succeed. (Kristiani & Werastuti, 2020).	CG=(Σ Disclosure of Governance Items)/(Σ Disclosure Items)	Ratio
4	ROA	Return on Asset is a comparison between profit after tax distribution and the company's overall assets (Brigham & Houston, 2006).	ROA = profit after tax/assets	Ratio

Source: Data processed by the author from selected books

Result and Discussion

Descriptive statistical analysis results

Table 2
Descriptive Statistics Results

Descriptive Statistics					
	N	*Minimum*	*Maximum*	*Mean*	*Std. Deviation*
ROA	36	.0010	.0380	.013528	.0094672
ENV	36	.0001	.1180	.034611	.0323925
SOS	36	.0020	.1400	.072500	.0396301
GOV	36	.0010	.2210	.093833	.0614615
Valid N (listwise)	36				

Source: SPSS 25.0 Output

Hypothesis Testing

Coefficient of Determination (Adjusted R)^2

The coefficient of determination test aims to measure how far the ability of the independent variable is in explaining the variation in the dependent variable (Ghozali, 2018). Shows that the variable variable based on the results of the value of the *Adjusted R Square* obtained, has a result of 0.106 or 10.6%. ROA variables can be explained by 10.6%. by *Environmental, Social, Governance* variables while the remaining 89.4% can be influenced by other factors not examined.

Partial Test (T-Test)

The t-value test is used to measure how far the influence of one independent variable individually in explaining the variation in the dependent variable (Ghozali, 2018). The results of the t-value test underlie the preparation of the research model which can be formulated as follows:

ROA = 0.086 + 0.240ENV - 0.126SOC - 0.002GOV

Table 7
T-value Test Results

	Hypothesis	B	Sig	α	Results
H_1	ROA has a significant positive effect on financial performance	0.240	.029	0.05	Accepted
H_2	*Social* has no significant effect on financial performance	-0.062	.623	0.05	Rejected
H_3	*Governance* does not affect financial performance	-.0.002	.978	0.05	Rejected

Source: SPSS 25.0 output (Data processed by the author)

Discussion of Research Results

Environmental to profitability

Based on the T-test results, it is found that *Environmental has a* significant effect on Financial Performance proxied by *Return on Assets* in banking companies listed on the Indonesia Stock Exchange for the 2019-2022 period. This can be seen from the test results where the regression coefficient value is 0.240 with a significance value of 0.029 (0.030 < α 0.05) so that the first hypothesis (H_1) which states that *Environmental has a* positive and significant effect on *Return on Asset* is accepted (H_1 accepted).

Environmental disclosure can maximize the company's brand image so that investors can be more interested in the company to provide venture capital for more advanced business continuity. Along with the provision of venture capital by investors, a positive corporate image and brand image also increase customer loyalty so that the company's

revenue also increases. Therefore, high environmental disclosure creates better potential for financial performance. (Inawati & Rahmawati, 2023). According to Dart (2004), legitimacy is the general perception or assumption that an entity's actions are desirable, appropriate, or appropriate within some socially constructed system of norms, values, beliefs, and definitions. With the existence of good *environmental* values in the company, the company will gain recognition from the community for creating a harmony of values and norms owned by the company with those owned by the community where which will have an impact on the sustainability of the company so that superior performance is obtained (Safriani & Utomo, 2020). The results of this study are in line with the research of Maftuchah (2018); Triyani et al. (2020); and Naeem et al. (2022) found that *Environmental has a* positive effect on Financial Performance. The research is not in line with the results of research conducted by Hakimah et al. (2019); Şeker & Güngör (2022); Johan & Toti (2022); found that *Environmental has a* negative effect on Financial Performance. Hutasoit & Sembiring (2020); Nugroho & Hersugondo (2022); Ihsani et al. (2023); Rizqi (2023); found that *Environmental does not affect* Financial Performance.

The effect of social on profitability

Based on the results of the T-test, it is found that *Social has no* significant effect on Financial Performance proxied by *Return on Assets* in banking companies listed on the Indonesia Stock Exchange for the 2019-2022 period. This can be seen from the test results where the regression coefficient value is -0.62 with a negative and unidirectional value and a significance of 0.623 (0.623>α 0.05) so that the first hypothesis (H_2) which states that *Social has a* significant effect on Financial Performance proxied by *Return on Asset* (H_2 rejected). This result is not in line with the legitimacy theory of Dart (2004), which shows that the high disclosure of social performance causes the company's financial performance to increase, this is due to the large relationship of trust between the public and consumers to the company so that the workforce becomes more loyal and enthusiastic because of its good social performance. Companies that conform to the expectations of society in their strategies are seen as increasing their legitimacy. This can be interpreted that perhaps the percentage of social disclosure in banking companies is not high enough. The results of this study are in line with the research of Ihsani et al. (2023); Putri & Puspawati (2023); who argue that *Social does not affect* Financial Performance. Ghazali & Zulmaita (2020); Hutasoit & Sembiring (2020); Zaman & Ellili (2022); Rizqi (2023); states that *Social has a* positive effect on Financial Performance.

Effect of governance on profitability

Based on the results of the T-test, it is found that *Governance has a* negative and insignificant effect on Financial Performance proxied by *Return on Assets* in banking companies listed on the Indonesia Stock Exchange for the 2019-2022 period. This can be seen from the test results where the regression coefficient value is -0.002 with a negative or unidirectional value and a significance of 0.978 (0.978> α 0.05). These results indicate that the *Governance* variable is proven to have a negative and insignificant effect on ROA (0.978 < α 0.05) so the first hypothesis (H_3) which states that *Social has a* significant negative effect on Financial Performance proxied by *Return on Asset* (H_3 is rejected). These results contradict the stakeholder theory by Donaldson & Preston (1995), which states that companies that have good governance will have good financial performance. Some factors that may explain this result are the high cost of implementing good governance, such as the cost of independent commissioners, board size, special committees, number of meetings, and shareholder rights. These costs will reduce the company's profit, which is the main component of ROA (Magni, 2015; Rostami et al., 2016). Then the difficulty of employees to innovate due to the long and strict SOPs that must be followed. This will hinder employee creativity and productivity, which also affects the company's financial performance. Johan & Toti (2022) Finally, the lack of transparency and the implementation of governance in companies, makes governance performance not accurately reflect the quality of the company and its financial performance (Dian, 2014). The results of this study are in line with research by Nugroho & Hersugondo (2022); Ihsani et al. (2023); Putri & Puspawati (2023); who argue that *Governance* does not affect Financial Performance.

3 Conclusion

This study aims to examine the independent variables consisting of Environmental, Social, Governance variables on Return on Asset. The coefficient of determination of this study shows the number 0.106 or 10.6%. ROA variables can be explained by 10.6%. By Environmental, Social, Governance variables while the remaining 89.4% can be influenced by other factors not examined.

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