The Influence of Environment, Social, and Governance (ESG) Practices on Bank Financial Performance

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Abstract
This study aims to investigate the impact of ESG practices on bank financial performance. To this end, we investigated 19 banks listed on the Indonesia Stock Exchange for the period 2020 to 2024, using regression analysis using STATA. The results indicate that ESG practices have a positive and significant impact on bank financial performance. This study also found that NIM has a significant positive effect on bank financial performance, while NPL and LDR have a significant negative effect. These findings can add to the existing literature on the relationship between ESG disclosure and financial performance. They also provide empirical justification for regulators and bank management to continue promoting and integrating ESG practices into banking business and operational strategies as part of efforts to create a more sustainable financial system.

Keywords: Environmental, Social, Governance, Bank Financial Performance

1. Introduction

The financial industry, as the initiator of ESG (todayesg.com), views ESG integration as a strategic imperative for the banking sector, no longer merely an ethical consideration. ESG is used not only as an indicator to measure a company's non-financial performance and sustainability but also as a management strategy crucial to its survival. As an intermediary institution, the banking industry plays a crucial role in the transition to a green economy due to its ability to distribute funds, which can influence the capacity and potential of the sectors receiving loans. This demonstrates market recognition that strong non-financial performance can reduce risk, enhance reputation, and ultimately contribute to long-term financial performance.

Furthermore, ESG reporting can also be useful for mitigating information asymmetry between companies and stakeholders, particularly investors. The higher a bank's ESG score, the lower its risk-taking level, leading to a healthier and more stable banking system. Companies that implement ESG effectively can create shareholder value by improving financial performance and management quality, while minimizing risk, which in turn positively impacts lenders' lending decisions.

The Financial Services Authority (OJK) actively promotes the implementation of sustainable finance through regulation, OJK Regulation (POJK) Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies. This regulation requires banks to gradually adopt eight principles of sustainable finance into their vision, mission, and business strategies. These principles are (1) responsible investment, (2) sustainable business strategies and practices, (3) social and environmental risk management, (4) good governance, (5) informative communication, (6) inclusiveness, (7) development of priority leading sectors, and (8) coordination and collaboration.

Then, in December 2020, the Indonesia Stock Exchange (IDX) launched the ESG Leaders index (IDX-ESG Leaders), consisting of 30 issuers with the highest ESG scores. This demonstrates the attention of the Indonesian capital market to ESG aspects, although its implementation and disclosure still vary. The results of a survey conducted by PWC Indonesia (2022) show that 78% of investors in Indonesia consider ESG factors in their investment decisions, but only 45% of companies actively integrate ESG into their business strategies.

Indonesian banks have demonstrated their commitment to sustainable business practices by integrating ESG issues into business decision-making. This is evidenced by the increasing share of financing in the green sector in Indonesia, despite the predominance of financing in the MSME sector (CPI, 2022). However, ESG implementation in the field still faces challenges, with the majority of Indonesian banks still showing low ESG scores, as found by Perkumpulan Prakarsa, 2022. According to the Perkumpulan Prakarsa (2022) report, the results of a bank assessment conducted by Bank Indonesia in 2022 showed low scores for elements of climate change, nature, human rights, and transparency and accountability. The survey shows a persistent gap between perceived importance and actual implementation of ESG practices by Indonesian banks, particularly regarding environmental aspects of financing.

According to the Financial Services Authority (OJK) report, the Indonesian banking sector has generally demonstrated stable and positive performance in recent years. Strong financial performance demonstrates sufficient financial capacity to implement ESG initiatives that may require significant initial investment. This indicates that banks have the financial strength necessary to absorb the initial costs associated with a comprehensive ESG strategy, such as new technology or sustainability programs, without significantly impacting profitability or short-term stability. Despite this positive performance, the banking sector faces several challenges. According to the OJK's Indonesian banking statistics report, several financial performance indicators declined in 2024 compared to 2023. For example, ROA fell from 2.55% to 2.44%, and Net Interest Margin (NIM) fell from 4.58% to 4.48%. Similarly, the ratio of Operating Expenses to Operating Income (OEOI) increased from 84.21% in 2023 to 89.01% in 2024.

JP Morgan, in its report, estimates that Indonesian banks will still face declining net interest margins due to funding costs and credit costs (Oktaviano Hana, 2025). As banks' operational environments become increasingly complex, ESG governance becomes increasingly important for mitigating various risks. Strong governance, as a core pillar of ESG, is crucial for developing

robust internal controls, ensuring data security, and maintaining transparency. This proactive approach to governance can help mitigate risks, protect a bank's reputation, and ultimately maintain its long-term financial performance. ESG can be considered an important determinant of bank solvency risk, given that ESG indicators can also be used to predict bank financial distress (Citterio & King, 2023). Furthermore, Khan et al. (2015) revealed that ESG information can predict a company's future financial performance.

Despite the growing literature on ESG in the banking sector (Agnese & Giacomini, 2023; Al Amosh & Khatib, 2022; Azmi et al., 2021), the empirical relationship between ESG and financial performance still yields varying and contradictory results (Tenucci et al., 2025). Some studies find a positive effect (Brooks & Oikonomou, 2018), while others find it contradictory (Hussain, 2018), insignificant, or even non-linear (Tenucci et al., 2025). For example, some studies indicate that higher ESG scores do not always have a positive impact on financial performance and firm value, and that social performance can even reduce profitability due to increased costs.

These discrepancies in results may be due to differences in ESG and financial performance measurement methodologies, statistical techniques used, industries analyzed, or data collection periods. Inconsistent or negative results demonstrate the complexity of the relationship between ESG and financial performance. This contradiction underscores the importance of further research on the impact of ESG on financial performance to better understand how ESG practices specifically impact various financial performance indicators of banks listed on the IDX, given the central role of banking in sustainable development and the ever-changing market dynamics. This research is also relevant to guiding investors, regulators, and bank management in effectively integrating ESG to create long-term value and ensure the sustainability of the Indonesian banking sector.

2. Literature Review and Theoretical Framework

ESG, or Environmental, Social, and Governance, is a set of standards that refer to three main criteria for measuring sustainability. According to the OECD (2022), ESG refers to the process of considering environmental, social, and governance elements in asset allocation and risk decision-making to generate sustainable long-term financial returns. The term Environmental, Social, and Governance (ESG) was first proposed by the United Nations Global Compact's "Who Cares Wins" initiative in June 2004 (ESG (todayesg.com). This concept considers that corporate performance must align with criteria and responsibilities for environmental, social, and governance impacts, as well as ethical and sound governance. ESG evaluates corporate performance based on specific environmental, social, and governance criteria, ensuring transparency and accountability for stakeholders and investors. Corporate social responsibility encompasses broad social initiatives; corporate sustainability emphasizes long-term resilience with balanced economic, social, and environmental practices (Bansal & Song, 2017).

The relationship between ESG and corporate financial performance has been explored through various theoretical frameworks (Shrestha et al., 2025). For example, stakeholder theory

emphasizes that a company's success depends on its ability to serve multiple stakeholders (Aydoğmuş et al., 2022). Given that ESG measurement can effectively assess a company's alignment with stakeholder interests (Kay et al., 2020), a positive relationship is expected between ESG performance and corporate financial performance. Furthermore, agency theory presents a contrasting view; some perspectives from agency theory also view ESG practices as unproductive expenditures that can negatively impact financial performance because management may pursue self-interest at the expense of shareholder value. Thus, pursuing ESG initiatives may be perceived as incurring agency costs and reducing firm value (Sundaram & Inkpen, 2004).

Institutional theory then proposes that ESG serves as a strategic tool to gain and maintain competitive advantage (Brower & Dacin, 2020), thereby improving a company's financial performance. However, institutional theory also recognizes that the relationship between ESG and a company's financial performance can vary significantly because companies operate within specific social norms encompassing geographic, cultural, and institutional contexts (Khan, 2022). Finally, legitimacy theory states that ESG implementation primarily aims to gain legitimacy and meet societal expectations, rather than to generate economic benefits. As a result, ESG activities can be separated from a company's core operations, potentially resulting in a disconnect between ESG and a company's financial performance (Brower & Dacin, 2020). In addition to these theories, various mechanisms such as asymmetric information, signalling, and shareholders are often considered, as ESG performance ultimately depends on managerial decisions to improve ESG compliance and disclose more information.

In the banking context, ESG practices can be applied, among other things, to lending decisions by financing companies capable of managing ESG risks and penalizing those that cannot (Erragragui, 2018; Nandy & Lodh, 2012; Thompson & Cowton, 2004). Some banks have decided to price companies' climate exposure by demanding higher lending rates from fossil fuel-based borrowers (Delis, 2021). The ultimate goal of this approach is a more effective credit risk management framework, which should result in improved asset quality, impacting financial performance. In this context, banks acting as socially responsible lenders by the ESG paradigm must avoid financial crises and strive to maintain financial stability. In this regard, previous research has explained the positive consequences of ESG scores on financial stability (Chiaramonte et al., 2022). Sustainable banks are generally more oriented towards stabilizing their long-term profitability, rather than focusing on short-term and highly volatile profits. They can achieve this goal by effectively managing ESG risks that may materialize in the medium or long term (Kalfaoglou, 2021) and by maintaining high-quality assets on their balance sheets, so they can reduce credit losses and maintain their financial performance over a longer period.

Several studies have focused on the key consequences of ESG performance and strategies across multiple dimensions (Cantero-Saiz et al., 2024). One particular focus is on the relationship between ESG and bank performance. For example, by analyzing an international sample of 46 listed banks, El Khoury et al. (2023) found a positive relationship between ESG scores and bank performance as measured by ROE and ROA, although this beneficial relationship reversed when

ESG scores were very high. Shakil et al. (2019) also provided evidence of a positive relationship between ESG and financial performance in a sample of 93 banks operating in emerging economies. Another meta-analysis of 132 articles published in reputable journals revealed that 78% showed a positive relationship between sustainability and corporate financial performance (Alshehhi et al., 2018). Meanwhile, a more recent meta-analysis found that 58% of papers found a positive relationship between ESG and financial performance, 8% found a negative relationship, 13% found no relationship, and 21% had mixed results (Whelan et al., 2021). They concluded that, although the majority expressed positive opinions, the results showed that there is still considerable heterogeneity on this topic.

Many researchers report a positive relationship between ESG performance and corporate profitability. However, some findings suggest that ESG disclosure has a negative relationship with firm value. For example, Landi & Sciarelli (2019) studied 54 listed companies in Italy from 2007 to 2015 and found a negative relationship between ESG scores and their financial performance.

Considering the literature review and previous research findings, as well as investor perceptions and public image of the company, it is expected that high ESG disclosure scores will positively impact corporate performance. Therefore, the following hypothesis is formulated:

Ha: ESG disclosure has a positive impact on the financial performance of banking companies.

3. Research Methods and Data

3.1 Research Data and Sample

This research is quantitative and utilizes secondary data. The data used is quantitative in the form of published annual reports. The data sources were annual reports published on the websites of each banking company and the Financial Services Authority (OJK) website, www.ojk.go.id/id/kanal/perbankan/data-dan-statistik/laporan-keuangan-perbankan.

The research sample consisted of banking companies listed on the Indonesia Stock Exchange (IDX) that have implemented sustainable finance for financial services institutions, issuers, and public companies since 2020, by publishing Sustainability Reports for the 2020 fiscal year. Therefore, the companies used in this study spanned the years 2020 to 2024. Of the 47 banking companies listed on the IDX, only 19 have published sustainability reports consecutively. Therefore, the total number of observations in this study was 95.

3.2 Research Variables

The variables in this study are ESG (Environmental, Social, and Governance) disclosure and financial performance. The independent variable used in this study is ESG disclosure. The independent variable, ESG disclosure, is measured using the ESG reporting standards published by Nasdaq in 2019, which include 10 environmental disclosure criteria, 10 social disclosure criteria, and 10 governance disclosure criteria. A company that discloses information is given a

score of 1; a company that does not disclose information is given a score of 0. The disclosure results are then summed and divided by 30 criteria.

The dependent variable in this study is financial performance. To measure financial performance, the Return on Assets (ROA) ratio is used, which is net profit divided by total assets.
This study also uses control variables, including NPL, LDR, CAR, NIM, and the leverage ratio.

To measure these variables, the following operational definitions and measurement scales are presented in Table 1:

Table 1. Variable Description

Variable	Description
ESG	10 Environmental disclosure criteria, 10 Social disclosure criteria, and 10 Governance disclosure criteria. If a Company discloses, it is given a score of 1; if the company does not disclose, it is given a score of 0. The disclosure results are then summed and divided by the 30 criteria.
ROA	Annual Net Profit divided by Total Assets
ROE	Annual Net Profit divided by Total Equity
NPL	Number of Non-Performing Loans divided by Total Loans
LDR	Total Loans divided by total Deposits
CAR	Capital Adequacy Ratio
NIM	Net Interest Margin
R_Lev	Liabilities to Assets Ratio

3.3 Analysis Method

This research focuses on investigating the extent to which ESG disclosure impacts financial performance. This model can be illustrated as follows:
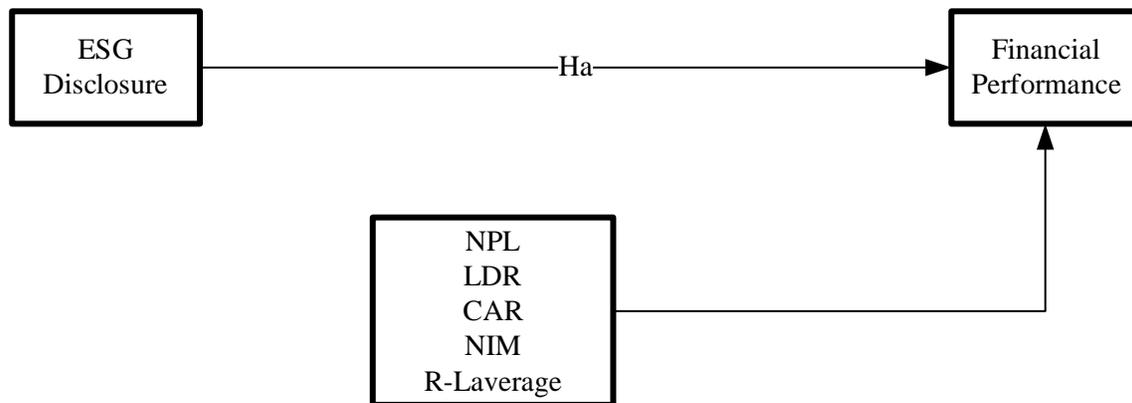

Figure 1. Research Model

To test whether ESG disclosure affects financial performance in banking companies, we used regression analysis using STATA version 14.0, a powerful statistical package widely used by researchers in the field of economics. In general, the following regression equation model is used to test the hypothesis:

$$ROA_Q = \beta_0 + \beta_1 ESG_{it} + \beta_2 NPL_{it} + \beta_3 LDR_{it} + \beta_4 CAR_{it} + \beta_5 NIM_{it} + \beta_6 R.Lev_{it} + e_{it} \quad (1)$$

In this study, in addition to the main test, we also conducted an additional test by replacing the financial performance measurement tool with ROE (Return on Equity), which is net profit divided by total equity. with the following regression equation model:

$$ROE_Q = \beta_0 + \beta_1 ESG_{it} + \beta_2 NPL_{it} + \beta_3 LDR_{it} + \beta_4 CAR_{it} + \beta_5 NIM_{it} + \beta_6 R.Lev_{it} + e_{it} \quad (2)$$

4. Results

4.1 Descriptive Statistics.

Descriptive statistical analysis was performed to show the minimum, maximum, mean, and standard deviation values for each research variable. The results of the descriptive analysis for each research variable are presented in Table 2. As shown in the data presentation in Table 2, the average value for the financial performance variable in the banking companies in the research sample was 1.99705. During the observation period, the ROA variable had a maximum value of 11.43 and a minimum value of -3.36, with a standard deviation of 2.06378.

Table 2. Descriptive Statistics

Variable	Observation	Mean	Std. Dev.	Minimum	Maximum
ROA	95	1.997053	2.06378	-3.36	11.43
ESG	95	.7442105	.1142094	.43	.93
NPL	95	2.606316	.9639127	.97	4.97
LDR	95	81.92905	17.14134	49,6	147
CAR	95	24.45232	8.618865	10.5	58.27
NIM	95	5.954401	5.300617	.22	28.30043
R_LEV	95	.8360168	.063696	.57	.9111111

Source: STATA (processed 2025)

The descriptive test results for the ROA variable demonstrate the distribution characteristics of the analyzed variable's values. The average ROA value of 1.99705 indicates that, on average, companies in the study sample generated a profit of 1.99% of their assets. The maximum value of 11.43% indicates the highest ROA value in the sample. This figure indicates that at least one company is highly efficient at generating profits from its assets.

The minimum value of -3.36 indicates that a company in the sample experienced a loss of approximately 3.36% of its assets. This means that the company was unable to generate profits but instead experienced a decline in the value of its assets. Furthermore, the standard deviation

value of 2.063 indicates the level of dispersion or variability in ROA data above the average value. The greater the standard deviation, the more varied or heterogeneous the ROA values between companies. This value indicates that there are significant differences in asset profitability performance among the 95 observed data sets. Some samples had ROAs above the average, while others were below the average. Overall, the results of this descriptive test indicate that although the average company in the sample demonstrated positive asset profitability (approximately 1.99%), there is considerable variation in this performance. Some companies excelled in utilizing their assets to generate profits, while others experienced losses. The relatively large standard deviation emphasizes that ROA performance is not uniform among the companies studied.

The ESG disclosure variable has an average value of 0.7442, with a maximum value of 0.9300 and a minimum value of 0.4300, while the standard deviation value is 0.1142. The average value of 0.7442 indicates an average ESG disclosure score of 74.42%, meaning that overall, companies disclosing ESG practices have been running well in terms of environmental, social, and governance sustainability, although there is still room for improvement. Furthermore, the maximum score of 0.93, which is close to 1, indicates that some sample companies are very good at disclosing ESG practices, while, when viewed from the minimum value, some sample companies are still low in disclosing ESG practices. In general, these results indicate that the majority of companies in the sample have quite good and relatively uniform ESG performance. Although there are differences between the best and worst-performing companies, the spread is not too wide. This could indicate that ESG awareness and practices are starting to become the norm among conscientious entities, with most striving to achieve decent or good standards.

The control variable, NPL, had an average value of 2.61%, indicating that, on average, the proportion of non-performing loans (NPLs) of total loans disbursed by companies in the sample was 2.61%. An NPL ratio below 5% is generally considered to be within tolerable limits and indicates fairly healthy asset quality. Therefore, this average indicates that, in general, the financial institutions in the sample have maintained credit quality. Although the highest NPL value was 4.97%, which is close to the upper limit of a healthy NPL ratio tolerance (5%). Although still below 5%, this figure indicates that the institution faces greater challenges in maintaining its credit quality compared to others. Furthermore, the lowest NPL value was 0.97%. This indicates that there is at least one financial institution with excellent asset quality, with only about 0.97% of its loans being Non-Performing. This indicates very effective credit risk management. Furthermore, the standard deviation value of 0.9639 indicates the level of dispersion or variability of NPL values below the average value. This indicates that the data tends to be more homogeneous, with most NPL values in the sample being close to each other or to the average. Overall, the NPL condition in the sample data tends to be stable and under control.

Furthermore, the LDR ratio shows an average value of 81.93%, indicating that the average bank has disbursed loans amounting to 81.93% of its total third-party funds. The standard deviation value of 17.14 indicates that the distribution of LDR data varies quite a bit around the average value, with most banks having LDRs that deviate by around 17.14% from the 81.93% figure.

The LDR range in this data is quite wide, starting from 49.6% as the lowest value, to 147% as the highest value. The minimum LDR of 49.6% indicates that some banks are relatively conservative in their credit distribution compared to the funds collected, while the maximum LDR of 147% indicates that some banks are very aggressive in disbursing credit, even exceeding the third-party funds collected, possibly by relying on other funding sources such as interbank loans.

The average NIM of 5.95% indicates that the banks in the sample are, on average, quite efficient in generating net interest income from their earning assets. However, with a relatively high standard deviation of 5.30, there is significant variation in the ability of banks to generate profits from interest margins. This is reinforced by the very wide range of values, where the lowest NIM was recorded at 0.22%, indicating a bank with a very low net interest margin, while the highest NIM reached 28.3%, indicating a bank with efficiency or a very aggressive and profitable interest setting strategy. The average leverage ratio was 0.84, indicating that the banks in the sample were, on average, funded by debt amounting to 84% of their total assets. The very small standard deviation of 0.06 indicates that the level of leverage across banks tends to be very homogeneous or does not vary much, with most banks having leverage ratios close to the average.

4.2 Correlation

Table 3. Pearson Correlation

	ROA	ESG	NPL	LDR	CAR	NIM	R_LEV
ROA	1.0000						
ESG	0.1597	1.0000					
NPL	-0.3368	-0.2017	1.0000				
LDR	0.2073	0.2878	-0.2473	1.0000			
CAR	0.7561	0.0216	-0.1500	0.1850	1.0000		
NIM	0.8138	-0.0159	-0.0868	0.2508	0.8530	1.0000	
R_LEV	-0.7198	-0.0145	0.0953	-0.3156	-0.8310	-0.8682	1.0000

Source: STATA (processed 2025)

Table 3 presents the Pearson correlation coefficients between the study variables. The correlation between ESG disclosure and bank financial performance indicators is positive, consistent with the expectation that ESG disclosure has a unidirectional or positive relationship with corporate financial performance, with a value of 0.1597. The correlation coefficient is generally low to moderate.

To ensure the absence of multicollinearity in the study data, a diagnostic test was conducted by estimating the variance inflation coefficient (VIF). For all reported regression models, all values were below the threshold of 10 (Table 4), indicating that multicollinearity did not affect the study analysis (Gujarati, D.N., and Porter, 2009).

Table 4. Variance inflation coefficient

Variable	VIF	1/VIF
NIM	5.31	0.188234
R_LEV	4.94	0.202576
CAR	4.43	0.225698
LDR	1.31	0.762723
ESG	1.13	0.885248
NPL	1.12	0.892671
Mean VIF	3.04	

Source: STATA (processed 2025)

4.3 Multivariate Analysis

Table 5 presents a regression analysis using equation (1) of the data collected for the research sample. A Chow test was first performed to determine the appropriate estimation model. The Chow test yielded a P-value (Prob>Chi^2) <0.05, so a Hausmann test was performed to determine whether to use fixed effects or random effects. The P-value (Prob>Chi^2) was 0.084, meaning that if the value was >0.05, the best choice was RE (random effect). To test the consistency of the influence of ESG disclosure on financial performance, we conducted two regression tests using different measures of the dependent variable. The first test used ROA (model 1), and the second used ROE (model 2).

Table 5. Regression Test Results

Independent Variable	ROA (Model 1)	ROE (Model 2)
ESG	2.6395 ***	38,2805 ***
NPL	-0.5381 ***	-4,1962 ***
LDR	-0,0120 *	-0.1044 **
CAR	0.0298	0.0547
NIM	0.2740 ***	0.9686 ***
R_LEV	-0.3493	23,6597
_cons	0.3526	-22,6334
Year	Yes	Yes
Observation	95	95
R-Squared	0.7457	0.456

Source: STATA (processed 2025)
Note: *, **, and *** indicate 10%, 5%, and 1%, respectively.

Based on the regression test results, the ESG coefficient for model 1 was 2.6395 with a significance level of 0.010, and for model 2, 38.2805 with a significance level of 0.000. Both models yielded significance levels below 0.05, indicating that ESG variables influence financial

performance, whether measured using ROA or ROE. This indicates that ESG disclosure significantly impacts bank financial performance.

The test results for the control variable, Net Interest Margin (NIM), showed a positive effect on bank financial performance, with a significance level of 0.00. Similarly, Non-Performing Loans (NPL) and Loan-to-Deposit Ratio (LDR) were negative. Therefore, NPL and LDR can be considered to have a significant negative influence on bank financial performance, at 0.00% for NPL and 0.09% for LDR. Company size, on the other hand, did not affect bank financial performance. The CAR and leverage ratio variables had no effect.

Model 2, using ROE as a measure of financial performance, yielded similar results, albeit with different significance values. The NIM variable positively impacted bank financial performance, while the NPL and LDR variables negatively impacted financial performance, and the CAR and leverage ratio variables had no influence.

5. Discussion

Based on the results of the regression test to examine the effect of ESG disclosure on banking financial performance, significance values were obtained at the 5% and 10% levels. These results indicate that ESG disclosure has a significant positive influence on banking financial performance, thus aligning with the proposed hypothesis. This finding indicates a reliable, unidirectional relationship between sustainability practices and financial performance in banking companies. A positive influence means that the higher a bank's ESG implementation or score, the better its financial performance, as reflected in indicators such as ROA, ROE, or NIM. Meanwhile, statistical significance indicates that the relationship is not due to chance but rather represents a real influence that can be empirically proven with a certain level of confidence, usually indicated by a p-value lower than the specified alpha.

The mechanism of ESG's influence on bank financial performance can be explained through environmental, social, and governance aspects. From an environmental perspective, banks that implement environmentally friendly practices tend to have higher operational efficiency through energy savings, waste reduction, and the adoption of green technology, which ultimately lowers operational costs. The social aspect contributes to improving the bank's reputation, strengthening customer loyalty, and expanding the customer base through social responsibility programs and inclusive services. Meanwhile, the governance aspect strengthens corporate governance, reduces operational and reputational risks, increases transparency, and improves the quality of strategic decision-making, which impacts long-term performance.

These findings have important practical implications for the banking industry and related parties. These results demonstrate that investing in ESG practices is not simply about meeting regulatory demands or pressure from external stakeholders, but also provides economic benefits for banks. Banks that consistently implement ESG principles tend to have easier access to funding at lower costs, the ability to attract institutional investors who increasingly prioritize sustainable investments, and greater competitiveness in the market. This also indicates that the Indonesian

financial market is increasingly mature in valuing sustainable business practices, so banks that ignore ESG aspects could face a long-term competitive disadvantage.

The results of this study corroborate those of El Khoury et al. 2023, which found a positive relationship between ESG scores and bank performance, as measured by ROE and ROA. Similarly, Shakil et al. 2019 also provided evidence of a positive relationship between ESG and financial performance in a sample of 93 banks operating in developing countries.

6. Conclusion

The concept of Environmental, Social, and Governance (ESG) has gained attention among industry players and investors. Companies in various countries are voluntarily engaging in more ESG practices, suggesting they may receive economic benefits (Yoon et al., 2018). Various international organizations, both private and governmental, are increasing their support for a sustainable economy. In Indonesia, ESG implementation has also attracted the attention of the Financial Services Authority (OJK), which has issued regulations encouraging companies listed on the Indonesia Stock Exchange (IDX) to disclose ESG information in their annual reports. In 2018, the OJK issued POJK No. 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies. Many countries have issued rules and regulations related to sustainability.
Therefore, this study examines the effect of ESG on the financial performance of banking companies listed on the Indonesia Stock Exchange. The sample was sourced from the annual reports of 19 banks between 2020 and 2024, with 95 observations used to test the research hypotheses. Findings from the fixed effects estimation method using STATA indicate that banks implementing ESG disclosures are expected to impact financial performance.

The regression test results indicate that ESG has a positive and significant impact on banking financial performance. This also applies to the control variables, namely NPL, company size, and company age. These findings indicate that banks that improve their integration and implementation of environmental sustainability practices, social responsibility, and strong and transparent corporate governance tend to show real and not coincidental improvements in financial performance. This study used a sample of banking companies listed on the Indonesia Stock Exchange (IDX), so the results may not be generalizable to non-financial companies.

Although the research results show a positive and significant impact, it is important to consider that bank financial performance is also influenced by various other external and internal factors, such as macroeconomic conditions, monetary policy, banking regulations, specific business strategies, and the unique characteristics of each bank. Therefore, interpretation of the results should be carried out carefully, considering the broader context. These findings also provide empirical justification for regulators and bank management to continue promoting and integrating ESG practices into banking business and operational strategies as part of efforts to create a more sustainable and resilient financial system.

The findings of this paper can further expand the existing literature on the relationship between ESG disclosure and financial performance. Furthermore, the findings of this study provide opportunities for further research on more effective ESG practices and how to raise investor awareness and encourage ESG practices to be a key consideration in their investment decisions. For regulators and companies, these findings can provide input for improving the quality and relevance of ESG implementation.

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