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The Relationship between ESG Practices and Banking Performance in Indonesia

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Research aims: This study examines the impact of environmental, social, and governance (ESG) factors on the financial performance of banks in the Indonesian banking sector. The analysis explores the relationship between 25 ESG pillar dimensions and bank performance indicators from 2019 to 2023.

Design/Methodology/Approach: A 129 data observation from 42 Indonesian banks was analyzed using three regression models to assess the influence of ESG initiatives on financial indicators. ESG dimensions, measured as dummy variables based on annual report disclosures, serve as independent variables, while performance indicators, measured using accounting and market variables, serve as dependent variables.

Research findings: The findings indicate that environmental factors do not have a significant impact on bank performance, while social and governance factors show a positive and significant influence. These results suggest that Indonesian banks focusing on social and governance initiatives are likely to achieve better financial outcomes.

Theoretical contribution/Originality: The study offers practitioners and academics a set of empirically validated ESG predictors relevant to bank performance.

Keywords: Bank; ESG; Indonesia; LST; Non-financial performance

Introduction

Environmental, social, and governance (ESG) considerations now play a central role in both academic and business settings. This shift reflects greater awareness among investors and corporations (Clément et al., 2025; Rau & Yu, 2023). ESG includes three key stakeholder relationships: environmental, social, and governance. These set standards for judging business operations and financial prospects (Dkhili, 2024; Wang et al., 2023). Companies use ESG factors to improve profits and build long-term value for shareholders (Al Amosh et al., 2022; Yuen et al., 2022).

ESG serves as a criterion for evaluating company performance (Wang et al., 2023). Following the 2006 United Nations (UN) Principles on Responsible Investment, studies increasingly focus on integrating ESG principles with economic factors. As economies and societies develop, ESG's importance grows. Investors and stakeholders increasingly demand

information on ESG performance to assess the sustainability and stability of economic actors worldwide (Menicucci & Paolucci, 2022; Yu et al., 2020).

As sustainability becomes more important, companies are under pressure to integrate ESG factors into business models to meet client and investor expectations. In banking, investor demand for sustainable products and regulatory requirements emphasize the incorporation of ESG risks into risk management. Integrating ESG into lending, investment, and product portfolios is seen as enhancing financial value (Al-Busaidi & Al-Muharrami, 2021; Chouaibi & Chouaibi, 2021) and supporting sustainable development. Including ESG in risk assessment and credit policies is an increasing priority for banks and regulatory authorities (Menicucci & Paolucci, 2022).

Companies share their ESG performance through disclosure. This increases transparency, influences investor choices, and improves the quality of the capital market. Disclosure also shapes stakeholders' perceptions of how companies respond to sustainability and ESG issues. Meeting ESG expectations can boost a company's reputation. ESG attention also helps companies gain legitimacy, especially in communities where social contracts matter. To show their efforts, companies often reflect local values and communicate these clearly through reporting.

Past ESG research links these topics to company performance and industry traits. ESG practices help companies avoid losses and build value. European data shows ESG factors improve market performance and raise Tobin's Q. Mohammad and Wasiuzzaman (2021) studied the impact of ESG disclosure on companies listed on Bursa Malaysia. They concluded that ESG disclosure improves company performance, even after accounting for competitive advantage. Fatemi et al. (2018) also show that ESG disclosure reduces information asymmetry and enhances investor perceptions of a company's investment strategy. This strengthens long-term performance and adds value by increasing reputation. Cho (2023) found that in emerging markets, investors favor ESG-focused investments during strong economic periods, confirming the nature of ESG demand.

This study continues prior work by evaluating ESG and bank performance in Indonesia. Indonesia, as a developing country, does not fully meet the efficient market hypothesis. Several obstacles, such as poor economic conditions and high corruption, hinder the development of its financial markets (Al Amosh et al., 2022; Hutapea et al., 2019). This study focuses on the relationships among ESG dimensions and performance indicators of banks listed on the Indonesia Stock Exchange (IDX) from 2018 to 2022. The analysis includes 1,161 observations. It tests how ESG initiatives affect bank performance indicators (Sari & Valdiansyah, 2025). Companies attract stakeholders by meeting their needs. A common approach is engaging in non-financial activities to gain attention. Sustainability and environmental initiatives target many stakeholders, not just shareholders, and may improve financial performance.

This study brings several contributions. It builds on past research by studying different aspects of business performance. It also adds new findings on what determines financial performance in a developing country. The results are expected to improve understanding of ESG policies in the Indonesian banking sector and may affect national sustainable development. The study also provides a detailed look at each ESG dimension. Practitioners and policymakers gain useful predictors to help Indonesian banks perform better.

Literature Review and Hypotheses Development

ESG Pillars and Bank Performance

ESG engagement integrates ethical and economic considerations, supporting economic stability (Menicucci & Paolucci, 2022). In banking, investors expect ESG principles to be embedded in business models to promote sustainable financial products. Integrating ESG factors into risk management and credit policies influences prudential regulation and is a strategic issue for banks and supervisory authorities.

The three ESG pillars—environmental, social, and governance (Wang et al., 2023)—serve as an analytical framework for investors to evaluate banks' conduct and future financial performance. Incorporating ESG considerations is expected to align with investor expectations and foster long-term value by developing sustainable products. Empirical evidence shows that ESG disclosure reduces information asymmetry and improves investor perceptions and recognition. Incorporating ESG considerations is expected to align with investor expectations and foster long-term value by developing sustainable products. Connect with stakeholders, namely individuals or groups that can influence company performance or are affected by the organization's success (Dkhili, 2024). From a stakeholder theory perspective, it is necessary to consider stakeholder preferences and expectations without discrimination (Deegan, 2009; Freeman & Reed, 1983). One way to meet these expectations is through corporate disclosure. Al Amosh et al. (2022) demonstrated that disclosing ESG-related information has significant value for stakeholders. Voluntary corporate disclosure by businesses is an important means of building relationships between businesses and stakeholders. This concept is widely accepted because articulating a company's goals, challenges, and issues becomes more effective when stakeholder concerns are disclosed in the corporate reporting process (Al Amosh et al., 2022). Corporate disclosure can also enhance the value-creation process for stakeholders by engaging them in detail and addressing their concerns, particularly those related to sustainability.

Meeting stakeholder expectations brings satisfaction and attracts investors and customers, making companies more competitive. Managing stakeholder engagement well can improve financial performance, reputation, and trust. Stakeholder understanding of ESG is important for company performance.

Legitimacy Theory

The legitimacy argument has been widely used in accounting reporting literature to explain why companies disclose social and environmental information (Deegan, 2009). From an ESG perspective, this argument is seen as a company's intention to gain legitimacy through its operations and social contracting (Al Amosh et al., 2022; Dkhili, 2024). In this context, companies use societal moral values as a basis for shaping their actions and plans. More specifically, companies legitimize themselves through transparent reporting. Transparent reporting is a common criterion for evaluating corporate activities.

Numerous studies have concluded that a company's financial performance can be improved by enhancing its legitimacy (Acquah et al., 2021). In this context, academic literature acknowledges that organizations are making significant strides in integrating ESG into their

operations and strategies (Lim et al., 2022). By gaining ESG-related legitimacy, companies can pursue long-term commercial development because their operations gain support from the local community.

The concept of legitimacy is often used by entities to account for their actions, not simply to secure legitimacy rewards (Patten, 2020). Entities' legitimacy depends on public awareness, which is why entities strive to manage their sustainability agenda (related to ESG) to influence stakeholder perceptions. In other words, disclosing a sustainability agenda can enhance an entity's legitimacy and acceptance in society while ignoring it can widen the legitimacy gap, thereby jeopardizing its legitimacy.

Entities increasingly face accountability challenges, particularly regarding their roles in issues arising from their operational activities. In response to these pressures, organizations have strengthened their disclosure practices, especially in sustainability, which, in turn, has encouraged improvements in the quality and extent of sustainability reporting (Patten, 2020). Broad recognition of an entity's legitimacy by key stakeholders, including customers and investors, can lead to higher returns and better financial performance, thereby supporting long-term value creation (Ali et al., 2021).

Environmental Disclosure and Bank Financial Performance

A bank's commitment to environmental issues can be viewed from three perspectives: funding environmentally friendly activities, reducing the risk of lending to environmentally damaging industries, and efficient use of resources within the bank. Therefore, integrating environmental considerations can serve as an indicator of an industry's commitment to environmental policies (Gangi et al., 2019). A commitment to environmental issues can also enhance a bank's reputation (Chang & Devine, 2019).

From a stakeholder theory perspective, a bank's orientation is not solely to fulfill its owners' objectives. It also has responsibilities to various stakeholders (such as customers, suppliers, government, and employees) who have an interest in the bank (Tan, Benni, & Liani, 2016), so banks need to provide the information they require. Meeting the desires of various stakeholders is believed to affect all segments of the capital market. Previous studies have demonstrated this relationship (Al-Shammari et al., 2022; Deswanto & Siregar, 2018; Horváthová, 2012; Iqbal et al., 2022; Lucas & Noordewier, 2016; Soedjatmiko et al., 2021). Therefore, this study develops the following hypothesis:

H$_1$: *There is a positive relationship between environmental aspects and bank performance.*

Social Disclosure and Bank Financial Performance

The intermediary role of banks is closely associated with corporate social responsibility (CSR), which encompasses activities such as ethical investment practices, financing non-governmental organizations, customer risk management, provision of efficient electronic payment systems, and the promotion of financial literacy and inclusion within society (Menicucci & Paolucci, 2022). A sustainable banking system plays a vital role in supporting overall economic stability (Aras et al., 2017), while the adoption of CSR strategies enables banks to build trust and maintain constructive relationships with their stakeholders (El Khoury

et al., 2023a; Wu & Shen, 2013). In particular, CSR implementation serves as a market signal that enhances investor confidence and provides banks with a competitive differentiation advantage. Prior studies indicate that socially responsible practices contribute positively to banks' long-term financial performance, competitive standing, and public image (Gangi et al., 2019), as well as to their corporate reputation (Buallay et al., 2020). Consistent with the social impact hypothesis grounded in stakeholder theory, higher levels of CSR engagement are expected to be positively associated with superior financial performance (Wu & Shen, 2013). Accordingly, this study proposes the following hypothesis:

H₂: *There is a positive relationship between CSR activities and bank performance.*

Governance Disclosure and Bank Financial Performance

Based on agency theory, stronger corporate governance is positively associated with superior firm performance. In the banking sector, innovation is essential for reshaping business models, reassessing value chains, and strengthening governance frameworks to enhance financial outcomes (Youssef & Diab, 2021). Robust governance mechanisms are required to effectively align managerial actions with shareholders' interests. Due to the distinctive nature of banking operations and the highly regulated environment, regulatory authorities play a pivotal role in encouraging banks to adopt sound and efficient governance structures (Menicucci & Paolucci, 2022).

Prior empirical studies have extensively explored the relationship between corporate governance quality and financial performance in banks (Ammann et al., 2011; Ben Fatma & Chouaibi, 2023; El Khoury et al., 2023a; Tiep Le & Nguyen, 2022). The findings generally suggest that effective governance mechanisms enhance financial performance by reducing agency conflicts. More specifically, well-designed governance practices contribute to improved managerial oversight, operational efficiency, and corporate reputation, while simultaneously limiting managerial opportunism. A bank's reputation is therefore closely linked to structured governance arrangements, prudent business process management, and effective internal control systems, as supported by prior studies (Ammann et al., 2011; Ben Fatma & Chouaibi, 2023; Tiep Le & Nguyen, 2022). Consequently, this study proposes the following hypothesis:

H₃: *There is a positive relationship between corporate governance and bank performance*.

Methodology

This study examines the relationship between ESG performance and financial outcomes in the Indonesian banking industry over a five-year period. Using available data, the sample consists of 47 banks listed on the Indonesia Stock Exchange, yielding a total of 1,161 bank-year observations spanning 2019 to 2023, the most recent five consecutive years at the time of the study.

The dataset offers several strengths for investigating the association between ESG dimensions and bank financial performance. First, the analysis is not subject to regulatory heterogeneity, as all sampled banks operate within the same institutional, regulatory, and governance framework. Second, the sample is relatively large and homogeneous, with all banks engaged in similar banking activities under Bank Indonesia supervision. The sample includes medium-

and large-sized banks that primarily focus on corporate, commercial, and investment banking, and that possess comparable funding structures and capacities.

Research data were manually collected from the Indonesia Stock Exchange and the official websites of the respective banks throughout the observation period. Financial performance is measured using Tobin's Q, return on assets (ROA), and return on equity (ROE). Tobin's Q serves as a market-based indicator that captures firm value and reflects the extent to which bank performance aligns with or exceeds capital market expectations. It also reflects firms' ability to enhance shareholder wealth by increasing equity value (Mohammad & Wasiuzzaman, 2021; Mohammed & Aldabbagh, 2024). In addition, accounting-based performance indicators, namely ROA and ROE, are employed as complementary measures of financial performance, as both are extensively used in prior empirical studies (Al Amosh et al., 2022; Menicucci & Paolucci, 2022).

Table 1 Variable Measurement

Dependent Variable	
ROA Financial performance	Measured as net income after tax divided by average total equity
ROE Operational performance	Measured as net income after tax divided by average total assets
TQ Market performance	Market capitalization divided by total book value of assets
Independent Variable	
L Environmental performance disclosure	Dummy, 1 for disclosing item; 0 for not disclosing item
S Social performance disclosure:	Dummy, 1 for disclosing item; 0 for not disclosing item
TK Governance performance disclosure	Dummy, 1 for disclosing item; 0 for not disclosing item
Control Variables	
UKP Company size	Natural log of total assets
USP Company age	Year of company establishment
LK Financial leverage	Total debt divided by total equity

Source: Developed by Researchers (2024)

The independent variable, ESG-related information disclosure, is measured using key indicators grouped into three environmental, four social, and three governance categories (see Table 1). Data were extracted from financial reports using content analysis (Krippendorff, 2013), which offers stakeholders insights into a company's sustainability contributions. ESG

performance disclosure is quantified using a dummy variable: a score of 1 is assigned if an item is disclosed, and 0 if it is not. The specific disclosure items for each ESG aspect are detailed in Table 2.

Table 2 ESG Aspects

Aspect	Element	Theme
Environment	Emissions	1. Emission 2. Waste 3. Biodiversity 4. Environmental management systems
	Innovation	5. Product innovation 6. Green revenue, research and development, and capital expenditure
	Resources use	7. Water 8. Energy 9. Sustainable packaging 10. Eco-friendly supply chain
Social	Community	11. Bank donations, bank policies to support volunteer activities
	Human rights	12. Human rights
	Product responsibility	13. Responsible marketing 14. Product quality control 15. Data protection policy
	Workforce	16. Diversity and inclusion 17. Career development and training 18. Workforce conditions 19. Health and safety
Governance	CSR strategy	20. CSR strategy 21. ESG reporting and transparency
	Management	22. Structure (independence, diversity committees) 23. Compensation 24. Shareholder rights 25. Takeover defence

Source: Al Amosh et al. (2022) Modified (2024)

Several control variables are included in this study, namely bank size, bank age, and leverage, to account for their potential influence on the relationship between ESG disclosure and financial performance. Larger banks may possess stronger financial positions, leading to higher performance. Older banks typically have more experience and established strategies for enhancing profitability. Additionally, financial leverage is recognized as a significant factor in improving company performance, with a higher debt-to-equity ratio amplifying its impact on profits (Al Amosh et al., 2022).

Research Methods

The following regression equation was developed to verify the impact of ESG disclosure dimensions on company performance:

Model 1: $KB_{i.t}$ = alpha + $beta_1 L_{i.t}$ + $beta_2 S_{i.t}$ + $beta_3 TK_{i.t}$ + $beta_n K_{i.t}$ + e

where:

KB is bank performance, represented by market performance (Tobin's Q); L is environmental performance disclosure; S is social performance disclosure; and TK is governance performance disclosure. K is a control variable consisting of UKP (firm size), UKS (firm age), and LK (financial leverage).

This study conducted additional analysis to verify whether ESG is strictly maintained on bank performance (Ben Fatma & Chouaibi, 2023). We conducted additional robustness analysis using different measures of the dependent variable (bank performance), including Tobin's Q, ROA, and ROE, which represent operational and financial performance, respectively, as has been done by previous researchers (Al Amosh et al., 2022; Dkhili, 2024).

Results and Discussions

Descriptive Statistics

Table 3 provides descriptive statistics for the dependent, independent, and control variables for the entire sample. The minimum Tobin's Q value was 0.02, and the maximum was 0.51, with an average of 0.18. The minimum ROA was -0.89, the maximum was 3.45, and the average was 0.97. The minimum ROE was -8.96, the maximum was 21.46, and the average was 6.31. The minimum values for the independent variables, including environmental, social, and governance performance, ranged from 0.1 to 0.33, with maximums of 1 and averages of 0.56, 0.66, and 0.68, respectively. In general, except for financial leverage, all variables in this study had narrow distributions, resulting in relatively good data dispersion. This can be observed from the variable's average value, which was generally higher than its standard deviation.

Table 3 Descriptive Statistics of Research Data

	N	Minimum	Maximum	Mean	Std. Deviation
Company age (USP)	129	9	105	45.98	18.71
Company size (UKP)	129	29.05	35.23	31.71	1.53
Financial leverage (LK)	129	0	1.66	0.45	0.47
Environment (L)	129	0.1	1	0.56	0.18
Social (S)	129	0.33	1	0.66	0.20
Governance (TK)	129	0.33	1	0.68	0.16
Tobin's Q	129	0.02	0.51	0.18	0.11
ROA	129	-0.89	3.45	0.97	0.85
ROE	129	-8.96	21.46	6.31	5.71

Source: Processed Research Data (2024)

Before testing the research hypotheses, a number of classical assumption tests were conducted, including tests for normality, heteroscedasticity, multicollinearity, and autocorrelation. The histogram (Figure 1) and p-p plot (Figure 2) showed a normal distribution pattern (skewed to the right in the histogram), and the points followed and approached the diagonal line (p-p plot). Meanwhile, the heteroscedasticity test using a scatter plot (Figure 3) indicated that the data points were spread above and below zero and did not form a distinct pattern. These results indicate that the data were free of heteroscedasticity.
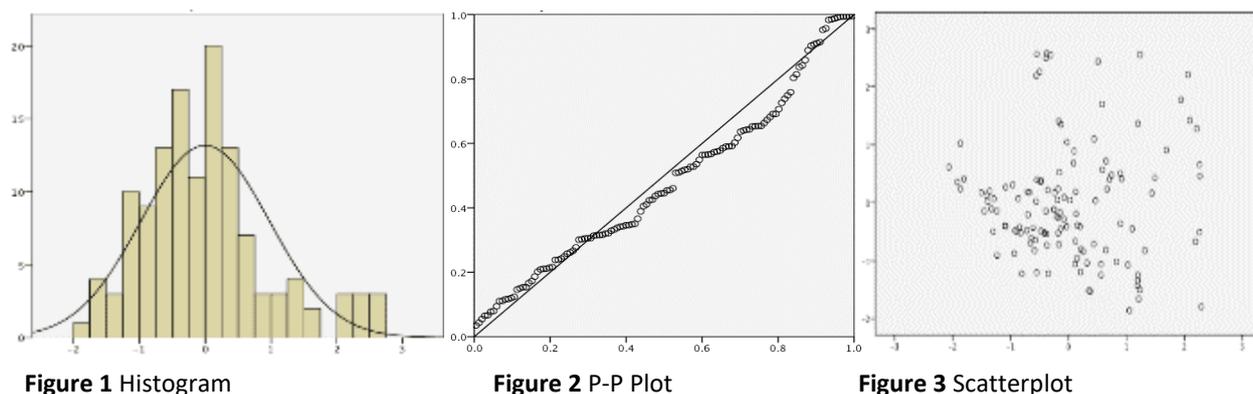

Figure 1 Histogram   **Figure 2** P-P Plot   **Figure 3** Scatterplot

Table 4 shows that the VIF and tolerance values are within the maximum limit of 1.548 for VIP, and the tolerance values range from 0.646 to 0.779. Therefore, there is no multicollinearity among the study variables.

Table 4 Multicollinearity Test

Tolerance	VIF
0.692	1.445
0.646	1.548
0.727	1.376
0.720	1.390
0.779	1.283
0.754	1.327

Source: Processed Research Data (2024)

To test the research hypothesis, a regression analysis was conducted to measure the influence of the independent variables, namely ESG indicators covering environmental, social, and governance aspects, on the dependent variable, namely bank financial performance, as measured by ROA, ROE, and Tobin's Q. Furthermore, the study also included control variables indicating the age, size, and leverage of the bank in the research model specification. Table 5 presents the results of the regression test that includes all these variables.

Table 5 Regression results using Tobin's Q as performance measures

Variable	Tobin's Q	
	Coefficient	Significance
Constant	0.056	0.813
USP	0.000	0.748
UKP	0.001	0.920
LK	-0.062	0.010
L	-0.152	0.017
S	0.181	0.001
TK	0.129	0.053

Source: Processed Research Data (2024)

Table 5 shows that ESG indicators perform well when linked to Tobin's Q, a measure of financial performance. However, this result is not supported by other models that use ROA and ROE as proxies for financial performance. Another important finding is that, although variables related to environmental aspects (L) statistically influence Tobin's Q, the direction is not as expected (positive), contrary to the research hypothesis that these variables are in line with bank performance. Meanwhile, social variables (S) and governance (TK) have worked as expected.

Discussions

Table 5 shows the relationship between ESG indicators and various types of bank performance included in the research design. The data indicate that environmental performance has a significant negative relationship with market performance (Tobin's Q; coefficient = -0.152, p = 0.017). Therefore, the first hypothesis (H_1) of this study is not supported by the data from the research sample (Sari & Valdiansyah, 2025). This result is inconsistent with studies conducted by Al Amosh et al. (2022) and Khlif et al. (2015), which concluded a positive and significant relationship between environmental factors and market performance, as measured by Tobin's Q. However, the findings of this study align with those of El Khoury et al. (2023b), who concluded that environmental performance is negatively related to bank performance. The rationale for this finding is that resource expenditure on environmental activities, such as pollution reduction and reclamation, is a burden on the company and reduces profitability, ultimately impacting its competitive advantage.

Furthermore, the study's results indicate a significant effect of social disclosure on market performance, as measured by Tobin's Q (coefficient = 0.181, p = 0.001) (Safitri, 2025). Thus, hypothesis two (H_2), which posits that social factors influence bank performance (Tobin's Q), is supported by this study, and the results are consistent with those of Al Amosh et al. (2022). Companies that pay more attention to social issues are perceived favorably by various stakeholders, leading them to view the company more positively, which ultimately can improve its market position and financial performance. Similar results also hold for the relationship between governance and market performance, as measured by Tobin's Q.

The findings related to governance performance disclosure explain its potential impact on banks' Tobin's Q (coefficient = 0.127 and significance = 0.053) and these results are in line with research conducted by Ammann et al. (2011) and Ben Fatma and Chouaibi (2023) but

contradict research conducted by El Khoury et al. (2023a, 2023b) and Al Amosh et al. (2022). The findings in this study support the third hypothesis (H₃), which states that banks in Indonesia that pay attention to governance aspects have good Tobin's Q values , and this may indicate that disclosure of information related to governance aspects, such as information on social responsibility strategies and management structures, is important to establish strong bank market performance. From the perspective of stakeholder theory, providing the information stakeholders need is an effort to build good relationships between banks and various parties. Optimizing relationships among the various parties involved can ultimately improve bank performance and its reputation (Al Amosh et al., 2022; Dkhili, 2024).

In this study, we included several control variables, namely bank size, bank age, and leverage, into the research model, as adopted by several researchers (Al Amosh et al., 2022; Dkhili, 2024). The regression test results for these three control variables showed no effect on market performance (Tobin's Q) (Safitri, 2025). This finding aligns with previous studies.

Model Robustness Test

As an additional procedure to assess the model's robustness, the authors used alternative measures of bank performance: ROA as a proxy for operational performance and ROE as a proxy for financial performance (Al Amosh et al., 2022). The results indicated that none of the ESG aspects affected bank performance, whether measured by operational (ROA) or financial (ROE) performance (Indrasuci & Rokhim, 2023).

Table 6 Regression results using ROA and ROE as performance measures

Variable	ROA		ROE	
	Coefficient	Significance	Coefficient	Significance
Constant	-7.502	0.000	-62.218	0.000
USP	0.008	0.063	0.012	0.659
UKP	0.263	0.000	2.159	0.000
LK	0.088	0.578	0.431	0.674
L	-0.342	0.423	-0.214	0.938
S	-0.317	0.384	-1.754	0.454
TK	0.224	0.618	0.894	0.757

Source: Processed Research Data (2024)

As shown in Table 6, using alternative measures of the dependent variable yielded findings inconsistent with those of the previous model. Likewise, with regard to the control variables, except for bank size (UKP), none had an effect on bank performance.

Conclusions

ESG considerations have garnered significant attention from academics and practitioners globally. Banks are increasingly confronted with challenges arising from social disruptions and climate change. Regulators and policymakers are tasked with encouraging the industry to develop and implement strategies that effectively address these issues. This study investigates the effect of ESG dimension disclosure on the performance of banks listed on the

Indonesia Stock Exchange (IDX). The findings reveal that, while environmental factors do not significantly impact performance, social and governance factors positively influence bank performance indicators, as measured by Tobin's Q.

The study's findings on the impact of ESG disclosure on performance are inconclusive. Therefore, there is ample scope for future similar studies using more diverse data and a broader scope. For example, future researchers could use samples from non-financial industries, as ESG disclosure levels vary considerably across industries. Furthermore, many factors were not captured in the research model developed in this study, including potential interactions with other factors in evaluating company performance. Therefore, future researchers could consider factors that might strengthen the relationship between non-financial performance and financial performance.

This study has several limitations that could guide further research. First, it focuses solely on the context of a developing country, namely Indonesia. More empirical research comparing similar countries could provide a broader perspective. Second, the study focused on corporate financial performance. Future research could include other indicators not discussed in this paper, such as working capital and gross profit margin. Furthermore, other factors related to corporate governance or board characteristics could be tested in the same context.

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