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The Impact of ESG and Governance Factors on Financial Performance: A Business Development Perspective on Commercial Banks Listed on the Indonesia Stock Exchange

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Abstract:

Currently, the issue of sustainability is one of the focuses for many companies. The application of the principles of environmental sustainability, social responsibility, and good governance is important for organizations to increase profitability. The intent of this study is to examine the influence of ESG and governance variables, especially independent board and board gender diversity, toward financial performance. This study involved the population of commercial banks listed on the Indonesia Stock Exchange during 2018-2022. The sampling technique used is purposive sampling method, resulting in a sample of 13 banks. Data testing using SPSS statistical software. The findings demonstrated that financial performance is significantly impacted by ESG, independent boards, and board gender diversity.

Keywords: *ESG, Independent Board, Board Gender Diversity, Financial Performance.*

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1. Introduction

Now the principle of sustainability has become one of the essences for many companies, including the banking sector. A company must have the main goal in terms of finance, which is to make a profit. However, in addition, the company also has a responsibility that is as important as the financial aspect, namely ensuring that its operational activities do not have a negative impact on the surrounding environment (Mulzaki & Yulianti, 2024). The concept of ESG now the main guideline for companies to integrate sustainability practices in their operations. ESG not only provides ethical guidance for companies, but it has also proven to have implications for financial performance. A study states that ESG can significantly affect financial performance (Sari & Widiatmoko, 2023). In their research, it was also stated that companies that disclosed more ESG information outperformed companies that disclosed less ESG information. This shows that companies that adopt ESG policies strategically can improve their reputation and sustainable competitive advantage, which will ultimately attract investors and improve financial performance.

The first aspect of corporate governance in this study is an independent board. According to Reswita & Rahim (2020) an independent board can protect the interests

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of shareholders and improve firm value by monitoring and advising managers in designing and executing corporate strategies. So it can be interpreted that the independent board acts to ensure that decisions taken by management are aligned with stakeholders. Another governance variable examined in this research is board gender diversity, which board gender diversity refers to women's participation in the board. This women's existence may increase the company's awareness of sustainability issues, which ultimately contributes to improving company performance. As in research Harijanto & Widiatmoko (2023), proven that financial performance is significantly impacted by gender diversity. In their research, it was revealed that more composition of the female board in a bank can stimulate an increase in the bank's financial performance.

Earlier studies about the clout of ESG and governance variables on financial performance showed mixed results. Sari & Widiatmoko (2023) discovered that ESG significantly impacts financial performance. However, Syaputra & Rahadi (2022) and Putri & Puspawati (2023) found that ESG was not proven to affect financial performance. Then, a study revealed that financial performance is significantly impacted by gender diversity (Harijanto & Widiatmoko, 2023), while other research found no evidence of a substantial relationship between financial performance and the attendance of female on the board (Kusuma et al., 2018). In addition, earlier research focused on non-financial sector companies as well as manufacturing. The findings of Dharmawati et al. (2024) and Nugroho & Hersugondo (2022) demonstrates that Environmental, Social, and Governance (ESG) significantly affects on company performance in the manufacturing sector, while Inawati & Rahmawati (2023) found similar results in companies in the non-financial sector. Therefore, this study will further explore whether ESG and governance variables are related to financial performance in the banking sector.

The intent of this study is to examine the influence of ESG and governance variables, especially independent board and board gender diversity, toward financial performance of commercial banks listed on the Indonesia Stock Exchange. This study is hoped to provide theoretical benefits by adding literature about ESG and corporate governance, as well as providing practical benefits for policymakers in the banking sector to increase the company's performance and sustainability by implementing ESG and effective governance.

2. Theoretical Background

Financial Performance: In a company, financial performance is an assessment or evaluation of the extent to which an entity, be it a company, organization, or individual, is able to achieve the financial goals that have been set (Dharmawati et al., 2024). To assess financial performance in a company, one of which can be using Return on Assets (ROA) (Nugroho & Hersugondo, 2022). ROA is utilized to gauge a company's ability to result in profit from assets owned and used optimally (Harijanto & Widiatmoko, 2023). In this research, ROA is used to measure financial performance.

ESG (Environmental, Social, and Governance): ESG (Environmental, Social, and Governance) is an aspect used to integrate sustainability business practices while acting as a non-financial indicator, which includes three aspects, namely environmental, social, and governance (Yudha & Rahman, 2024). The environmental aspect includes environmental sustainability, such as waste management, reduction of greenhouse gas emissions, energy use efficiency, and conservation of natural resources. Meanwhile, social aspects include the company's relationships with employees, communities, and customers, such as human rights protection, occupational safety, corporate social responsibility, and community involvement. The governance aspects include practices such as transparency, accountability, business ethics, good board structure, and shareholder rights protection (Nabilah & Ahmadi, 2024).

Independent Board: Independent board has a crucial role to enhancing corporate governance, by acting as a neutral party that is not affiliated with the company. According to (Korir & Cheruiyot, 2017; Apriliani & Dewayanto, 2018), independent board members are considered professionals in making decisions because they are recruited from outside the organization, so that they are able to provide an objective view of various company policies. The study Apriliani & Dewayanto (2018) also emphasized that the presence of an independent board aims to monitor and discipline management, which can encourage the improvement of the company's performance. Beside that, an independent board as a go-between for the owners and managers of the company, which eventually increases the owners' trust in the company's performance. It means an independent board is important in creating good corporate governance and supporting business sustainability.

Board Gender Diversity: According to Harijanto & Widiatmoko (2023) and Eliya & Suprapto (2022), gender diversity refers to women who serve as boards in companies such as boards of commissioners or directors. The growing proportion of female commissioners and directors on board is evidence that the push for gender equality has affected many organizations to offer the same chances to everyone, regardless of gender (Farida, 2019). According Pramesti & Nita (2022), women in leadership positions will tend to be more cautious, risk-averse, and do not make hasty decisions, so that the resulting policies tend to be more mature and able to reduce company risks. In addition, gender diversity can improve on overall company performance, where gender equality creates a more inclusive work environment and encourages improved organizational performance (Mulzaki & Yulianti, 2024).

ESG's Effect on Financial Performance

Nugroho & Hersugondo (2022), found evidence that ESG disclosure significantly affects company performance. Indicates that transparency in environmental, social, and governance aspects can increase investor confidence and create added value for the company. In addition, Sari & Widiatmoko (2023) revealed that ESG has a substantial impact on financial performance. However, other findings state otherwise that ESG disclosure has no clout on financial performance (Putri & Puspawati, 2023). Similar research results from Khairunnisa & Widiastuty (2023) which revealed no

significant clout of ESG on financial performance. Based on the diverse findings above, this study proposes the following hypotheses:
H1: ESG significantly affects financial performance.

Independent Board's Influence on Financial Performance
Earlier studies revealed a significant impact by the board independent of the financial performance (Syaputra & Rahadi, 2022). Furthermore, discovered by Reswita & Rahim (2020) that an independent board significantly influences financial performance (ROA). This is caused independent board to carry out supervisory functions more objectively, because they have no direct affiliation with the company's management, so that it can minimize conflicts of interest and make quality decisions, which can ultimately increase investor confidence and the financial performance. Thus, the following is the formulation of the study's hypothesis:
H2: Independent board significantly affects financial performance.

Board Gender Diversity's Effect on Financial Performance
The discussion of the relationship between board gender diversity and financial performance has been an interesting topic in various studies. Earlier studies showed mixed results, with some studies finding significant results of board gender diversity is able to significantly impact financial performance (Syaputra & Rahadi, 2022; Harijanto & Widiatmoko, 2023). This is based on the view that gender diversity is able to make quality decisions and encourage innovation through more diverse perspectives. However, research by Kusuma et al. (2018) and Apriliani & Dewayanto (2018) yielded different findings, they did not find the significance of gender diversity on financial performance. Therefore, the proposed hypothesis is:
H3: Board gender diversity is able to significantly impact financial performance.

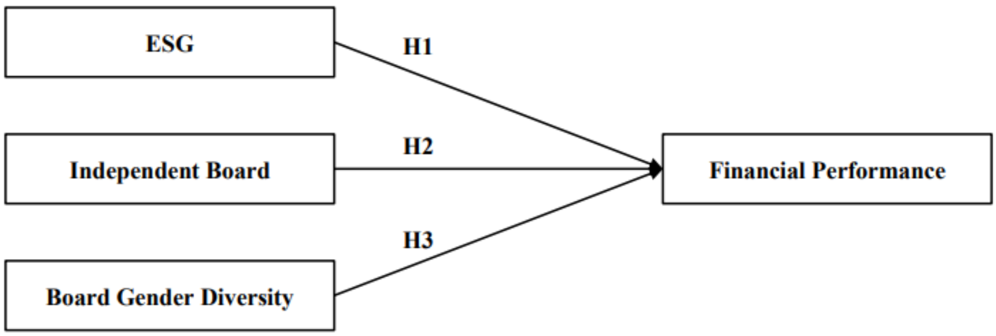

Figure 1. Research Framework

3. Methodology

This test utilizes a quantitative approach because it examines the variables using numerical data that is statistically analyzed, to find out the relationship. This study involved the population of commercial banks listed on the Indonesia Stock Exchange during 2018-2022. From this population, the sample was determined using the purposive sampling method, with the criteria of commercial banks that consistently have ESG scores during the research period. There were 13 banks that met the criteria for 5 years, and 65 observations were obtained. Utilizing secondary data obtained from the ESGI Dataset website. Data analysis using SPSS statistical software.

Table 1. Operational Variables

Variable	Measurement	Source
Dependent Variable:		
Financial Performance (ROA)	Net income divided by total assets.	Syaputra & Rahadi (2022)
Independent Variable:		
ESG (ESG Score)	The esg score from number of items environment, social, and governance disclosed divided by number of items based on GRI.	Syaputra & Rahadi (2022)
Independent Board	Proportion of the number of independent board members divided by the total number of board members.	Syaputra & Rahadi (2022)
Board Gender Diversity	Proportion of the number of female board members divided by the total number of board members.	Paolone et al. (2024)
Control Variable:		
Leverage (DAR)	Total debt divided by total asset	Dicuonzo et al. (2024)
Firm Size	Natural logarithm of total asset	Dicuonzo et al. (2024)

Information:

ROA	= Financial Performance
ESG	= ESG
INDEP	= Independent Board
FEMALE	= Board Gender Diversity
DAR	= Leverage
SIZE	= Firm Size

4. Empirical Findings/Result

Determination Coefficient Test (R^2)

Table 2. Results of the Determination Coefficient Test

Model Summary[b]				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.913[a]	0.834	0.820	0.00197

Table 2 above, presents an R Square result of 0.834, means that 83.4% of the ROA may be elucidated by ESG, INDEP, FEMALE, DAR, and SIZE. The difference of 16.6% is a variable that was not included in this test.

F Test (Simultaneous)

Table 3. F Test Results

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	0.001	5	0.000	59.218	0.001[b]
	Residual	0.000	59	0.000		
	Total	0.001	64			

As shown in Table 3 the Sig. values is 0.001 < 0.05 so it can be interpreted that collectively the dependent variables are influenced by independent variables.

T Test (Partial)

Table 4. T Test Results

Coefficients[a]						
		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	- 0.129	0.008		- 15.290	0.001
	ESG	- 0.005	0.001	- 0.223	- 3.965	0.001
	INDEP	- 0.005	0.002	- 0.135	- 2.284	0.026
	FEMALE	- 0.006	0.003	- 0.134	- 2.323	0.024
	DAR	0.004	0.002	0.124	2.251	0.028
	SIZE	0.004	0.000	0.958	16.519	0.001

Table 4 shows the results that the independent variables ESG, INDEP, and FEMALE significantly affect ROA, as indicated by their Sig. < value of 0.05. The control variables DAR and SIZE also resulted in a Sig. value of < 0.05 so they also affect ROA significantly.

5. Discussion

The Effect of ESG on Financial Performance

T-test results in table 4, indicate that the ESG variable has value Sig. of 0.001 < 0.05. May infer that the financial performance (ROA) was significantly influenced by ESG, so H1 is accepted. This result explains that if ESG is practiced in the company's operations, it positively influences profitability. In other words, a company tends to have better financial performance if it is more committed to sustainability principles reflected in ESG.

This study's yield is comparable with several earlier studies. According to Sari & Widiatmoko (2023), ESG significantly affects the financial performance. Besides that, Inawati & Rahmawati (2023) found that there is a substantial impact of ESG factors on financial performance in non-financial sector companies. Meanwhile, Dharmawati et al. (2024) and Nugroho & Hersugondo (2022) assert that ESG significantly affects performance of manufacturing companies. However, this research finding contradicts with Putri & Puspawati (2023) that found no clout of ESG disclosure on the financial performance. Other research also shows that ESG has no clout on financial performance (Khairunnisa & Widiastuty, 2023).

The Influence of Independent Board on Financial Performance

T-test results in table 4, the significance of the independent board variable (INDEP) is 0.026 < 0.05. May infer that the financial performance (ROA) was significantly influenced by the independent board, therefore H2 is accepted. Independent board in companies is a crucial role to improve transparency and management supervision, which in turn can reduce potential conflicts of interest and improve decision quality. Through more effective supervision, companies can maximize the utilization of their assets, which will ultimately increase the company's profitability.

Findings of this study are aligned with several earlier research. The study Syaputra & Rahadi (2022) found that financial performance was significantly affected by independent boards. Then, Reswita & Rahim (2020) also revealed that ROA is influenced by ESG in banking companies. Nevertheless, this research finding contradicts with (Apriliani & Dewayanto, 2018), which didn’t find a significant effect of independent board on the company's performance in the manufacturing sector.

The Effect of Board Gender Diversity on Financial Performance

T-Test results in table 4, the value of Sig. from the board gender diversity variable (FEMALE) of 0.024 < 0.05, which can be said to be significantly influenced by the gender diversity board, so H3 is accepted. This finding indicates that the attendance of female on the board can participate to improve financial performance in a company. Gender diversity in the board can carry a broader perspective in decision-making, optimize the quality of corporate governance, and encourage innovation and operational efficiency.

This study has results that are aligned with several former studies. Research conducted by Syaputra & Rahadi (2022) revealed that board gender diversity is proven to significantly affect financial performance. In addition, Harijanto & Widiatmoko (2023) also found a significant influence of gender diversity on financial performance in the banking sector. This indicates that the presence of women in leadership can optimize corporate governance performance. However, this study generated the opposite with several other studies. Apriliani & Dewayanto (2018) discovered that the attendance of female on boards doesn't significantly influence the financial performance of manufacturing companies, while Kusuma et al. (2018) in banks.

6. Conclusions

From the test result, it can be inferred that ESG, independent board, and board gender diversity significantly affect financial performance (ROA). The implementation of good ESG can increase a company's profitability through environmental sustainability, social responsibility, and good governance. The attendance of an independent board in companies is a crucial role to improve transparency and management supervision, and improved decision-making quality, so that the company can optimize its assets. Besides that, gender diversity in the board also has an important role because it can carry a broader point of view in decision-making, improve governance, and encourage innovation and operational efficiency. In general, this study obtained test results are aligned with several earlier studies, although there are some conflicting findings, this is suggesting that the impact between these variables can vary depending on the characteristics and industry sector of the company.

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