THE ROLE OF THE ENVIRONMENT, SOCIAL AND GOVERNANCE IN BANKING PERFORMANCE
(Scientific Literature Review)

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Abstract: This research aims to measure the determinants of banking performance, the indicators used in this research are CAR, BOPO, LDR, and NPL, which are moderated by Environmental, Social, and Governance (ESG). In this research, all banking sector companies are included in the category Bank Groups based on Core Capital (KBMI) 3 and Bank Groups based on Core Capital (KBMI) 4, listed on the Indonesia Stock Exchange (BEI) for the 2018-2022 period. The population in this study was 13 commercial banks to determine the number of samples from which data were taken.

Keywords: Company Performance, ESG, CAR, BOPO, LDR, and NPL

1. INTRODUCTION

Financial performance is an analysis carried out to see the extent to which a company has implemented financial implementation rules properly and correctly (Fahmi 2018: 142). Measuring company performance is crucial for management to evaluate and plan future goals. According to Ni Luh, et al (2018) Bank financial performance is a reflection of the level of success of a bank in its operational activities. Banks that can always maintain good performance, especially with a high level of profitability and are able to distribute dividends well and their business prospects can always develop and can meet the provisions of prudential banking regulations well. This is the main and very important factor in order to comprehensively assess banking performance, starting from debt, liquidity, asset valuation, and others.

This research uses grouping of banks based on core capital used (KBMI) in accordance with Financial Services Authority Regulation No.12/POJK.03/2021, Chapter XVI article 147, namely KBMI 1 with core capital of up to 6 trillion rupiah; KBMI 2 with core capital of more than 6 trillion rupiah to 14 trillion rupiah; KBMI 3 with core capital of more than 14 trillion rupiah to 70 trillion rupiah; and KBMI 4 with core capital of more than 70 trillion rupiah. Indonesian Banking Statistics data released by the Financial Services Authority (OJK) shows trends in the financial performance of commercial banks from 2018 to 2022 as shown in Figure 1 below:

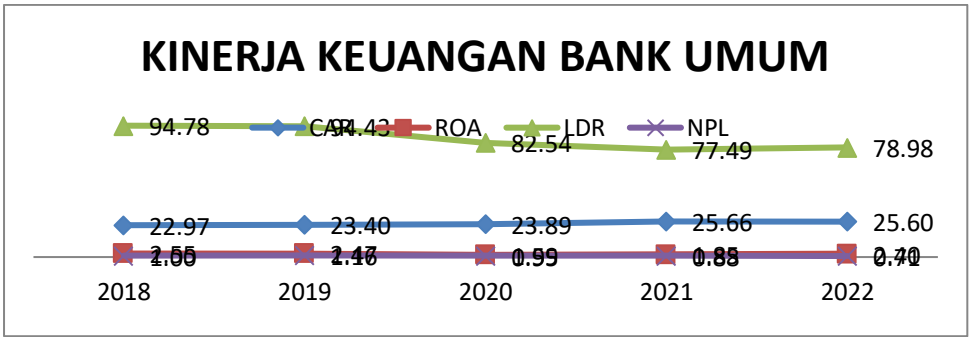

Figure 1.1 Performance of Conventional Commercial Banks in Indonesia
Source: Indonesian Banking Statistics (www.OJK.go.id)

In Figure 1.1 above, over the last 5 years, namely in the 2018-2022 period, the average banking financial performance has fluctuated, including CAR, ROA, NPL and LDR. If you look at the CAR (Capital Asset Ratio), there is an increase in capital every year, if you look at the ROA (Return on Assets), there is a fluctuating increase and where the average ROA value is still below standard if you look at the capital, if you look at the NPL, there is a decrease every year starting from 2020 to 2023. If you look at the LDR (Loans Deposit Ratio), the average is still within the threshold (78%-92. Except for 2018 and 2019 where the LDR exceeded the threshold (78%-92%) namely 94.44%.

Banking performance is not only seen from financial performance but also from market performance. In this research, market performance is measured by stock performance using the Price Earning Ratio (PER) and Price Book Value (PBV) indicators. The market performance is measured by the Price Earning Ratio (PER) as shown in Figure 1.2 below:

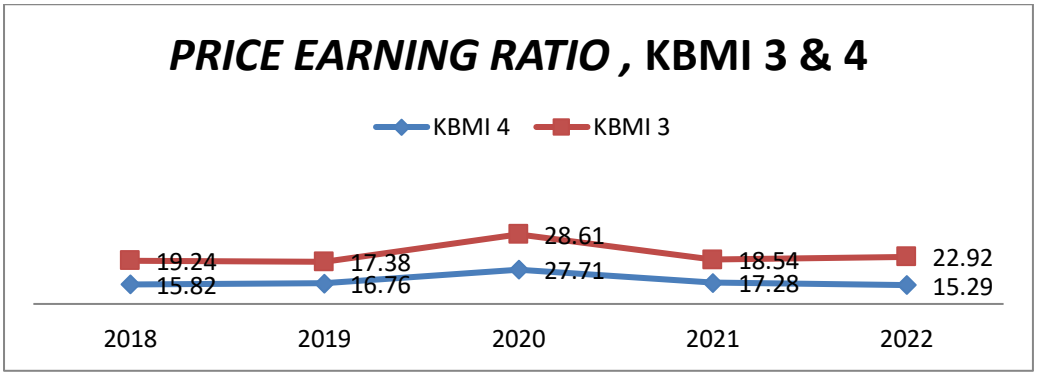

Figure 1.2 Market Performance Price Earning Ratio KBMI 3 and 4
Source: www.OJK.go.id(Data processed)

Based on figure 1.2, it is known that the PER (Price Earning Ratio) of KBMI 3 and KBMI 4 experienced a fluctuating increase. PER KBMI 3, the increase in share value is higher than PER KBMI 4. This shows that there are factors that influence the share price. According to Dewi and Sudiartha in Mujati and Dzulqodah (2016), the Price Earning Ratio shows the company's profit growth, and investors will be interested in this profit growth so that in the end it will have an effect on share price movements. A good PER standard is between 10-15 for the Indonesian Stock Exchange, while for exchanges with larger capitalization values it is usually 15-20. The higher the PER, the higher the value of the company. If the PER at KBMI 3 is seen from the capital, it is overvalued because it is above 15 times or even above 20 times. Meanwhile, the PER at KBMI 4, if seen from its capital, can be said to have a good share price because the average share value is below 20 times If you look at it from*Price Book Value*(PBV) which occurs as seen in Figure 1.3 below:

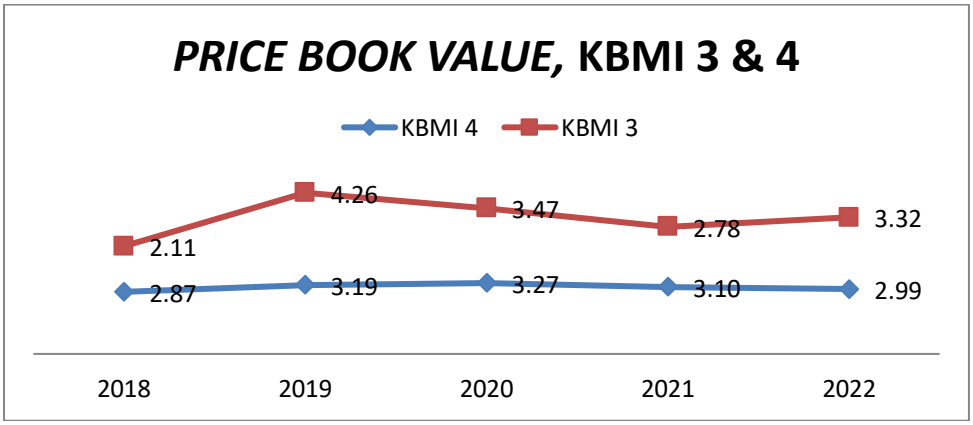

Figure 1.3 Market Performance Price Book Value KBMI 3 and 4
Source: www.OJK.go.id (Data processed)

Based on Figure 1.3, it is known that the development of PBV (Price Book Value) of KBMI 3 and KBMI 4 has seen a fluctuating increase. In KBMI 3 & 4, where the PBV value is above 1, it indicates that banking shares have a high valuation or are in an overvalued condition. Banking performance over the last 5 years, whether seen from financial performance or market performance, has fluctuated on average, indicating that there are factors that influence bank performance in generating profits. in accordance with Bank Indonesia regulation Number: 13/1 /PBI/2011 concerning assessment of the health level of commercial banks, where the health of the bank is a reflection of the condition and performance of the Bank.

Apart from paying attention to financial performance and market performance for the company's survival in the future, companies also need to pay attention to non-financial performance, one of which is ESG performance.ESG (Environmental, Social, and Governance) has developed rapidly in the world. Many countries have implemented ESG factors in every investment. 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 reports, although up to now, not all banks in Indonesia have implemented ESG.From the results of financial performance and market performance described above, the development of banking performance did not develop simultaneously and significantly, this shows that there are factors that influence the bank's performance. As isFinancial Services Authority Regulation Number 51/Pojk.03/2017 concerning the Implementation of Sustainable Finance (Sustainability Report) for Financial Services Institutions, Issuers and Public Companies, is it able to encourage and effectively improve banking performance, both financial performance and market performance through the Capital Adequacy ratio? Ratio (CAR), BOPO, LDR, and NPL

2. LITERATURE REVIEW

Companies that will make investments must have accurate planning or calculations so that these decisions can produce profits for the company in the future. To determine the success of a company, of course the company needs capital expenditure. According to Brigham and Daves (2010), capital expenditure is a long-term investment planning process carried out by a company in order to maintain company profits. Researchers have carried out many tests regarding the effect of capital expenditure, but the results obtained from previous tests have not been consistent.

Several researchers found that Capital Expenditure has a positive effect on performance (Moussa & Elmarzouky, 2023); (Taipi & Ballkoci, 2017); (Kim & Li, 2021); (Chwee, 2019). But the research contradicts research(Alfadhli & Alali, 2021;Harrison, 2021;Cordis and Kirby, 2016; Hertzel and Li, 2010) found that capital expenditure had a negative effect on company performance.

Capital Adequacy Ratio is ratio to measure the capital adequacy of a bank to meet minimum capital obligations or what is called solvency or ability to pay its obligations (Winarso & Park, 2020). Capital Adequacy Ratio (CAR) is the minimum ratio between risk capital and assets containing risk. Several previous researchers have conducted research on the relationship between capital adequacy and banking financial performance with inconsistent results. (Zahid et al., 2023); (Twum et al., 2022); (Harrison, 2021); (Abdel Reda et al., 2016); (Ramdani et al., 2023). However, there are also research results which find that the CAR ratio has no effect on banking financial performance (Abdurrohman et al., 2020); (Luh Shintya Anggari & Made Dana, 2020); (Sari et al., 2023); (Atuahene et al., 2021).

Further more, to increase profitability, the bank makes efficiency in the company's operational costs. BOPO can also be measured quantitatively using the efficiency ratio. BOPO is the ratio between operational costs and operating income. "So, the lower the BOPO ratio means the better the performance of bank management so that it will get maximum profits" (Andriasari & Munawaroh, 2020; 249). The banking industry is an intermediary institution that uses many inputs and outputs. In measuring the level of bank efficiency, it can be measured by the BOPO ratio. Research related to the influence of the BOPO ratio on banking financial performance also provides inconsistent results. Research conducted by (Sudiyatno, 2010); (Rembet & Baramuli, 2020); (Al Zaidanin & Al Zaidanin, 2021) found that the BOPO ratio had a significant negative effect on bank financial performance. However, there are also research results which find that the BOPO ratio has a significant positive effect on bank financial performance (Primiana & Febrian, 2017); (Handayani et al., 2021); (Sudiyatno, 2010).

Apart from that, an important factor in banking is bank liquidity which is measured using the Loan to Deposit Ratio (LDR). Loan to deposit ratio (LDR) which is often used in assessing bank liquidity by comparing total deposits and total bank loans in the same period. If the loan to deposit ratio (LDR) calculation then shows a higher ratio number, then it will then lend out all the funds it has, so the bank is relatively illiquid. On the other hand, if the loan to deposit ratio (LDR) results are high, then the bank will then become liquid with excess fund capacity ready to be lent. According to Kasmir (2014:225), the safe limit for a bank's LDR is around 80% and the maximum LDR limit is 110%. The effect of liquidity on financial performance has also been studied by previous researchers who found inconsistent results. Several previous research results show that liquidity ratios have a significant positive effect on banking financial performance (Luh Shintya Anggari & Made Dana, 2020); (Awaluddin et al., 2023); (Sochib et al., 2023); (Raka et al., n.d.); (Rizky & Mahardika, 2018);(Jaworski & Czerwonka, 2021). However, based on research results (Steven & Toni, 2020); (Wiadnyani & Artini, 2023); (Sari et al., 2023) The LDR ratio does not have a significant effect on banking financial performance.

Non-performing loans is a big challenge for the banking sector, because it can reduce bank profitability. The banking sector's main source of income consists of loans provided by banks, but this process carries major risks for both lenders and borrowers. Credit risk is generally defined as the biggest risk that affects bank performance. Non Performing Loans is a comparison between non-performing loans and total credit (Ismail, 2018:32). Meanwhile, Sorongan (2020) believes that Non-Performing Loans are an indicator to measure a bank's business risk ratio which indicates the magnitude of the risk of non-performing loans occurring in the bank.

Several previous research results have conducted research on the influence of credit risk (NPL) on bank performance, providing inconsistent results. Study (Wiadnyani & Artini, 2023); (Ekinci & Poyraz, 2019); (Kassi et al., 2019), the research results state that credit risk has no effect on banking performance.However, based on research results (Abiola & Olausi, 2014); (Annor & Obeng, 2018); (Batten & Vo, 2019); (Young & Muturi, 2018) the research results stated thatr cedit risk has a positive effect on banking performance

Apart from paying attention to financial performance and market performance for the company's survival in the future, companies also need to pay attention to non-financial performance, one of which is ESG performance. ESG is a concept that prioritizes sustainable development/investment activities with three main factors, namely environmental, social and governance. According to the Organization for Economic Cooperation and Development / OECD (2022), ESG refers to the process of considering environmental, social and governance elements in asset allocation and risk decision making so as to produce sustainable long-term financial returns.

Several research results on the relationship between ESG disclosure and financial performance in the banking sector provide conflicting findings. Many studies show a positive relationship between ESG and bank performance for developed and developing countries (Albitar et al., 2020); (Velte, 2017); (Boulhaga et al., 2023); (Buallay, 2019a); (Kuo et al., 2022); (Chouaibi et al., 2022); (Fuadah et al., 2022); (Buallay, 2019b);(Buallay et al., 2021);;(Cornett et al., 2016);(Bătae et al., 2020);(Shakil et al., 2019); (Buallay, 2020); (Alareeni & Hamdan, 2020); (Ahmad et al., 2021). But research (Buallay et al., 2021;(Menicucci & Paolucci, 2022b); (El Khoury et al., 2023); (Climent, 2018); (Ruan & Liu, 2021). The same results were also shown by research from (Buallay, 2019a); (Maama, 2021); (Nollet et al., 2016)with insignificant and/or negative ESG research results on Return on Assets, Return on equity, and Tobin's Q.

3. RESEARCH PURPOSES

1. To test and analyze the influence of CAR on the performance of Banking Sector Companies
2. To test and analyze the effect of BOPO on the performance of Banking Sector Companies
3. To test and analyze the influence of LDR on the performance of Banking Sector Companies
4. To test and analyze the influence of NPLs on the performance of Banking Sector Companies
5. To test and analyze the role of ESG in moderating the influence of CAR on Banking Sector Company Performance
6. To test and analyze the role of ESG in moderating the influence of BOPO on Banking Sector Company Performance
7. To test and analyze the role of ESG in moderating the influence of LDR on Banking Sector Company Performance

8. To test and analyze the role of ESG in moderating the influence of NPLs on Banking Sector Company Performance

4. LITERATURE REVIEW

4.1 Financial Performance (Financial Performance)

Financial performance in a company is said to be very important because it functions to evaluate the company regarding the level of the company's capabilities in accordance with the financial activities that have been carried out.
According to Kurniasari (2014:12), financial performance is work performance in the financial sector that has been achieved by the company and is stated in the company's financial reports. Meanwhile, according to IAI (2014) Financial Performance is the company's ability to manage and control the resources it owns.

4.2 Market Performance (Market Performance)

Market performance to assessment of company performance by the market which is reflected in the value of a company based on the calculation of the share market price multiplied by the number of shares outstanding. Assessment of company performance can be done by looking at the added value and shortcomings reflected in the company's annual report. To assess market performance, many methods are used.

According to Hanafi (2004), capital market performance means the condition of the company's capital market in a certain time period which is different from previous conditions, where this performance is measured by market ratios consisting of earnings per share ratio, price earnings ratio, market to book value ratio, dividend income ratio, and dividend payout ratio. WhereasAccording to Hayati (2017), market performance refers to the assessment of company performance by the market which is reflected in the value of a company based on the calculation of the share market price multiplied by the number of shares in circulation. Assessment of company performance can be done by looking at the added value and shortcomings reflected in the company's annual report.

4.3 Capital Adequate Ratio (CAR)

Capital Adequate Ratio (CAR) is a ratio to describe the adequacy of capital that can be used to accommodate the risk of loss faced by the bank. The higher the CAR value, the better the bank's ability to bear credit risk/risky productive assets. According to Kasmir (Kasmir, 2016:46), the Capital Adequay Ratio (CAR) is a comparison of the ratio between capital and assets weighted according to risk and in accordance with government regulations. Meanwhile, according to (Winarso & Park, 2020), the Capital Adequacy Ratio is a ratio to measure the adequacy of capital a bank has in meeting its minimum capital obligations or what is called solvency or the ability to pay its obligations.

4.4 Operating Costs Operating Income

BOPO (Operating costs to operating income) is a ratio that describes banking efficiency in carrying out its activities. The smaller the BOPO value means the more efficient the bank is in operating.

According to Malayu SP Hasibuan (2017:101): Operating costs, operational income (BOPO) is the ratio of operating costs, operational income (BOPO) formulated as a comparison or operational costs to operational income in the same period. Meanwhile, according to Rivai et al. (2007), operating costs operating income (BOPO) is a comparison between operational costs and operating income in measuring the level of efficiency and ability of the bank in carrying out its operational activities.

4.5 Loan to Deposit Ratio (LDR)

Loan to Deposit Ratio is a ratio that measures a bank's ability to fulfill short-term obligations by dividing total credit by total third party funds (DPK). According to Dendawijaya (2015:116), Loan to Deposit Ratio (LDR) is the

extent to which providing credit to credit customers can offset the bank's obligation to immediately fulfill the requests of depositors who wish to withdraw their money which has been used by the bank to provide credit. In other words, LDR is used as an indicator to determine the level of vulnerability of a bank. Meanwhile, according to Riyadi (2015:199), Loan to Deposit Ratio (LDR) is a comparison of total credit to third party funds (DPK)

4.6 Non-Performing Loans (NPL)

Non Performing Loans is a ratio to measure the magnitude of the risk of problematic credit at a bank which is caused by customers not being able to make payments smoothly. According to Darmawi (2011:16) NPL is defined as one of the bank risk measurement ratios which shows the magnitude of the risk of problematic credit at a bank caused by non-smooth payments of loan principal and interest which will directly impact profit generation and decrease bank performance.

4.7 Environmental Social Governance (ESG)

ESG is an important factor in business and investment because it helps companies manage risk, build reputation and create a positive impact on the environment and society. A deeper understanding of this concept is key to ensuring that companies and investors can contribute to a more sustainable world.

There are three main aspects of ESG criteria, namely: 1. Environmental Criteria Environmental criteria discuss the company's impact on the surrounding natural environment during operations; 2. Social Criteria Social Criteria focus on the company's relationships with external parties, including communities, society, suppliers, customers, media and other entities that interact with the company; 3. Corporate Governance Criteria (Governance) These criteria focus more on external relations and emphasize how the company is regulated and managed internally. And corporate governance criteria cover various aspects, including company policies, company standards, company culture, level of transparency, audit processes and compliance.

CONCLUSION

Based on the explanation above, a research conceptual framework can be created:

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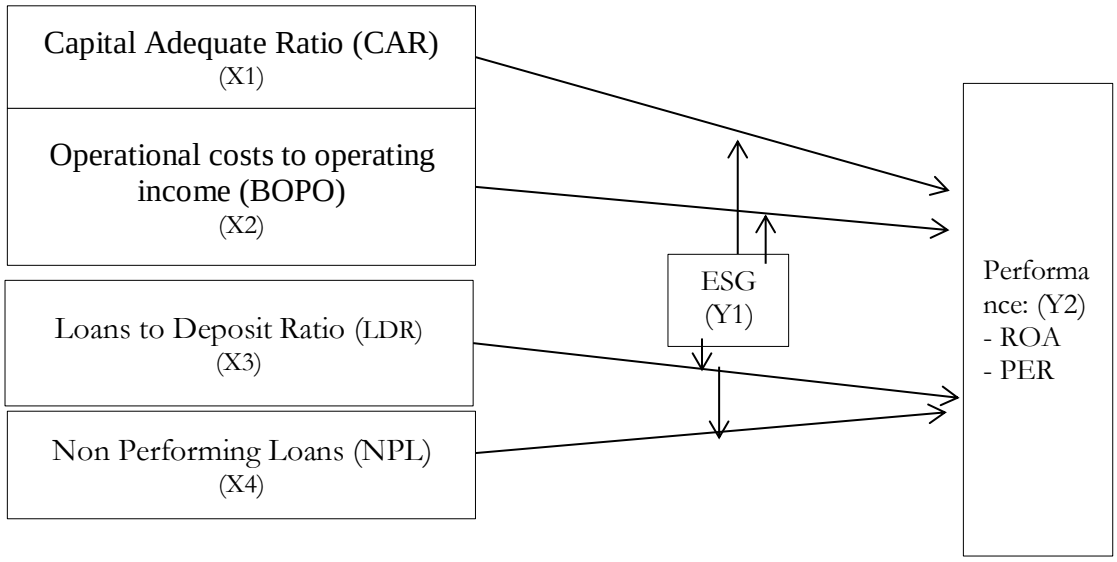

Based on a literature review of both theoretical and empirical research results, this research proposes a hypothesis that will produce an empirical research model, namely:

H: Capital Adeq1uacy ratio has a positive effect on performance in banking companies
H2: Operational costs to operating income (BOPO) have a positive effect on performance in banking companies
H3: *Loan to Deposit Ratio* (LDR) has a positive effect on performance in banking companies
H4: Non-Performing Loans (NPL) have a positive effect on performance in banking companies

H5: The role of ESG in moderating the Capital Adequacy ratio has a positive effect on banking performance
H6: The role of ESG is moderating Operational costs to operating income (BOPO) have a positive effect on banking performance
H7: The role of ESG is moderating Loan to Deposit Ratio (LDR) has a positive effect on banking performance
H8: The role of ESG in moderating Non-Performing Loans (NPL) has a positive effect on banking performance

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