

## RESEARCH ARTICLE



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# Do sustainability practices contribute to the financial performance of banks? An analysis of banks in Southeast Asia

Herenia Gutiérrez-Ponce<sup>1</sup> | Sigit Arie Wibowo<sup>1,2</sup>

<sup>1</sup>Department of Accounting, Faculty of Economics and Business, Autonomous University of Madrid, Madrid, Spain

<sup>2</sup>Universitas Muhammadiyah Yogyakarta, Yogyakarta, Indonesia

## Correspondence

Herenia Gutiérrez-Ponce, Department of Accounting, Faculty of Economics and Business, Autonomous University of Madrid, Madrid, Spain.

Email: [herenia.gutierrez@uam.es](mailto:herenia.gutierrez@uam.es)

## Abstract

In response to the need to deepen research on the impact of corporate ESG (environmental, social, and governance) pillars on the financial performance (FP) of banks, this study analyzes the relationship between ESG and FP in banks from emerging countries in Southeast Asia during the period 2010–2020. Using a sample of 19 banks from five countries with emerging economies, this article examines the level of information on ESG activities that banks report in each of their pillars and these pillars' impact on the FP. The research was conducted through an exploratory study using panel data (Thomson Reuters ESG data), parametric correlations, and regression models. FP is measured by return on assets (ROA), return on equity (ROE), and Tobin's Q (TQ), or the prevailing market price for exchanging assets divided by the market price of the goods newly produced. The findings show that ESG has a significant negative effect on all measures of FP (ROA, ROE, and TQ). However, analysis of the relationship of each individual ESG pillar to FP obtains different findings for each. Our study also shows differences in the level of ESG information in each country as a result of their specific economic characteristics. This study has limitations due to the limited ESG, bank, and country data that Thomson Reuters contains on banks in this region of Asia. In future research, more banks and more countries can be added to the analysis, as well as other control variables related to FP.

## KEYWORDS

banking sector, ESG dimensions, financial performance, return on assets, return on equity, sustainability reporting, Tobin's Q

## 1 | INTRODUCTION

The economic and financial crisis of 2008 raised concerns about the impact of sustainability activities on banks' financial performance (FP). Controversies and scandals regarding the role of banks in the crisis have also revealed failures in some dimensions of sustainability—environmental, social, and governance (ESG)—raising questions about banks' social responsibility policies, such as their real strategic commitment to main stakeholders (Esteban-Sanchez et al., 2017;

Hoang, 2023). The relationship between the performance of ESG activities and FP has been studied in companies from different sectors and regions, with studies obtaining a significant relationship between financial indicators and ESG information (Galletta et al., 2022; Gutiérrez-Ponce et al., 2022). More specifically, (Buallay et al., 2023) study the sustainability report in the banking sector in different economic and political environments and find a negative relationship between the ESG pillars and FP. The relationship between ESG and FP thus differs depending on the regulatory context of each region.

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Research has shown significant differences between developing countries, those of the European Union, Asia, and America (Aras et al., 2018; Cornett et al., 2016; Esteban-Sanchez et al., 2017; Gutiérrez-Ponce & Wibowo, 2023; Menicucci & Paolucci, 2022; Siueia et al., 2019).

Due to the important role banks play in the economy, they are often required to be transparent in their financial reports and non-financial information (Jizi et al., 2014; Khan, 2010). All countries are reviewing their regulations due to banks' condition of public interest, which imposes additional disclosure requirements related to financial intermediation activities (Marín et al., 2019). An "ethical banking" movement is putting additional pressure on financial institutions to be more sustainable and issue more information, both financial and non-financial, to their stakeholders (Tse, 2011). Because banks play an important role in economic development and financial stability worldwide (Scholtens & Van Klooster, 2019), disclosure of reports on ESG risks is increasingly requested from financial and banking entities. Furthermore, ESG disclosure plays a crucial moderating role by mitigating the negative effect of business weaknesses and attenuating the positive effect of strengths (Fatemi et al., 2018). Along these lines, (Aulia et al., 2023) analyzed what factors affect FP in the disclosure of ESG elements in banks in three Asian countries. They found that the main challenge in implementing green investment was lack of incentives from the government and stakeholders. (Jung & Yoo, 2023) argue, however, that the impacts of ESG activities and the market environment on company performance have not been sufficiently researched.

For all these reasons and based on the results of a study on the relationship between sustainability and FP in Indonesian banks (Gutiérrez-Ponce & Wibowo, 2023), it is necessary to extend the research to developing countries in Southeast Asia, on which there is little research. The purpose of this study is thus to analyze whether the ESG activities of Southeast Asian banks influence their FP and to determine which pillar of the triple bottom line (TBL) is most closely related to, or most influences, FP.

At an academic and practical level, consensus exists that banking strategy should include environmental protection, social improvements for stakeholders, and good governance (ESG). For example, when deciding to finance a project, the bank must assess not only the earnings but also the ESG risks that accompany the project and incorporate these into its good governance strategy to reduce commercial banking risks and improve shareholders' welfare (Bătae et al., 2020; Dmuchowski et al., 2023).

Investors' demand for sustainable products has generally increased in the past decade. Thus, financial institutions offer a full range of loans oriented to "green lending" and products such as green mortgages, lines of credit, and loans, as well as specialized financing projects linked to ESG criteria. Investment strategies offer green and social bonds to finance environmentally sustainable projects. Consideration of the term Finance from an ethical point of view—encompassing social, environmental, and climate-related factors—includes the current concept of Sustainable Finance. Consensus exists that Sustainable Finance conditions economic growth toward more humane balanced development. The term Socially Responsible

Investment refers to investments that include ESG criteria, as distinct from strictly economic criteria (risk, profitability, and liquidity). This study thus fills an important research gap by analyzing the relationship between sustainability and FP in a geographic setting of under-analyzed emerging economies.

Banks' ESG performance and its relationship to corporate FP define an ongoing field of interest for researchers, practitioners, and regulators. While it is important for banks to implement ESG policies, previous research on Southeast Asian banks has been scant. It is important to fill this research gap by examining whether financial companies with high ESG disclosures also show high FP.

Prior research on ESG and FP in banking has obtained mixed results (Bătae et al., 2020; Buallay, 2019, 2020; Buallay et al., 2020; El Khoury et al., 2021; Hwang et al., 2021; Kim & Li, 2021; La Torre et al., 2021; Menicucci & Paolucci, 2022; Nobanee & Ellili, 2022; Shakil et al., 2019). Study of the relationship between sustainability reporting and financial indicators in companies from different sectors and regions has obtained a significant relationship between financial indicators and ESG information (García-Benau et al., 2022; Gutiérrez-Ponce, Chamizo-González, et al., 2022; Gutiérrez-Ponce, González, et al., 2022).

Demand for ESG disclosure and regulations governing it is lower in developing than in developed countries. Furthermore, as banking in developing countries is characterized by countercyclical capital buffers (Moudud, 2019) and has enormous uncertainty and risk (Bilgin et al., 2021), ESG activities performed by banks in emerging economy countries can give stakeholders a good indication of the banks' FP (Azmi et al., 2021).

To achieve our study goal, with a focus on banks in emerging countries in Southeast Asia, we have posed the following research questions: RQ1: What level of information on ESG activities do Southeast Asian banks report across each of the three pillars? and RQ2: Do sustainability practices contribute to the FP of Southeast Asian banks?

We analyzed the relationship between ESG and FP in a sample of 19 banks from five Southeast Asian countries over the period 2010–2020.

The independent variable is the ESG score, calculated from the three ESG pillars. The data were obtained from the Thomson Reuters Eikon database. The dependent variables are ROA, ROE, and TQ (ratio between the market value of a physical asset and its replacement value). In addition to addressing a specific research gap, the relationship between ESG and FP in Southeast Asian countries' banking companies, we examine the impact of each of the three pillars of ESG on the variables analyzed, using statistical correlations and regression models as our research methodology. The first test on the relationship between ESG and FP used Spearman's correlation, the second investigated the effect of ESG on FP using multiple regression tests, and the third performed various ESG tests on each country using the Kruskal–Wallis test.

To our knowledge, this is the first study to examine the effect of ESG on the FP of banks in Southeast Asian countries. Interestingly, Southeast Asian countries are among the developing countries

significantly affected by the economic crisis in developed countries. Banks in these countries must, therefore, develop good ESG sustainability reporting practices.

This study makes several contributions to the literature on banks' performance in emerging economies. First, it examines ESG banking practices in Southeast Asia because these countries still lack academic research on ESG and its relationship to FP (Galletta et al., 2022). Second, this study performs an in-depth analysis of the three ESG pillars to determine which pillar is the most important in Southeast Asian banking. Third, this study compares banking ESG practices across countries to determine which countries have the highest ESG scores.

This study is divided into several sections: Section 1: Introduction; Section 2: Theoretical background, literature review, and hypothesis development; Section 3: Research methodology; Section 4: Results and discussion; and Section 5: Conclusions, implications, research limitations, and future research opportunities.

## 2 | THEORETICAL BACKGROUND AND LITERATURE REVIEW

The strategic behavior of companies regarding sustainability may be explained by standard approaches, such as legitimacy theory or stakeholder theory. The latter was introduced by (Freeman et al., 2010), who argued that companies have a responsibility toward a wide range of stakeholders, not just those traditionally considered.

According to legitimacy theory, a company generates a nexus of contracts that align corporate values with those of society (Archel et al., 2009), and an organization could perform sustainability-oriented activities to retain or acquire legitimacy (Fernando & Lawrence, 2014). According to Fernandez-Feijoo et al. (2015), following legitimacy theory, companies that operate in sensitive business sectors—that is, sectors with high social and/or environmental impacts—are more visible to the public and thus have a greater need to demonstrate that they are socially responsible and to legitimize their activities and role in society. According to a literature review on the determinants of sustainability information disclosure by (Ali et al., 2017), however, no such generally accepted theory exists. Most studies considered using a specific theory or combination of theories to explain the determinants (Cho et al., 2015; De Klerk & de Villiers, 2012; De Villiers & Van Staden, 2011).

According to stakeholder theory, companies in different sectors report sustainability in accordance with the expectations of their stakeholders (Reverte, 2009; Sweeney & Coughlan, 2008).

Agency theory posits that managers as agents focus on maximizing the company's profits to obtain recognition from the owner and obtain a reward for their performance, whereas the owner is more focused on reducing the costs that arise in the company's operations to increase profitability. This mismatch between the two parties can reduce agency costs that affect FP through implementation of good ESG practices (Buallay et al., 2023). This article focuses on stakeholder theory to analyze whether the ESG activities of banks in emerging Southeast Asian countries influence their FP.

An extensive literature in this line has investigated the connection between ESG and company performance, as shown in Brooks and Oikonomou (2018). These authors' study also identifies research gaps on socially responsible investing that have not been addressed to date. In a comprehensive overview of academic research on the relationship between ESG and corporate FP, Friede et al. (2015) find that approximately 90% of studies obtain a positive ESG-FP relationship.

The link between ESG and FP has thus been widely investigated using both theoretical (Sancak, 2023) and empirical (Chaudhry et al., 2021) approaches. Further, stakeholder theory argues that the company has a responsibility to all interested parties, including customers, suppliers, employees, the government, and society in general (Ferrell et al., 2010). To many interested parties, sustainability reporting is an important topic, and ESG information will create a long-term comprehensive advantage that extends beyond shareholders (Khelif et al., 2015).

According to the neoclassical paradigm, owners' and managers' ability to maximize profits and create value can be negatively affected by satisfying non-shareholder stakeholders (Galant & Cadez, 2017; Kusi et al., 2018). Other researchers argue that ESG standards lowered business financing costs, which in turn decreased corporate risk-taking behavior (Di Tommaso & Thornton, 2020; Oikonomou et al., 2014). Ashwin Kumar et al. (2016) show that organizations that implement ESG activities are less volatile than their counterparts in the same sector.

Extensive research has been performed on ESG and FP in banking, with positive significant results. For example, Wu and Shen (2013) examined 162 banks in 22 countries. Using banking data in America in the context of the 2008 financial crisis, Cornett et al. (2016) determined that banks, in general, seem to be rewarded for being socially responsible since FP is positively and significantly related to corporate social responsibility (CSR) scores. According to Carnevale and Mazzuca (2014) and Pérez and del Bosque (2015), CSR activities are one way to gain stakeholders' trust.

The study by Akdogan et al. (2020) of banking in Turkey supports the idea that different countries understand CSR differently, depending on their social structure and level of economic development. Along the same lines, Gutiérrez-Ponce and Wibowo (2023) find that the board of directors and stakeholders of Indonesian banks believe that ESG activities generate costs and have little impact on current and future FP. Jan et al. (2018) study sustainability practices and FP for Islamic banking industry in Malaysia. Siahaan et al. (2021) studies the impact of green banking and financial performance on the profitability of Indonesian banks and Kartadjuma and Rodgers (2019) found that higher compensation for executives in Indonesian banking entities can both motivate management's environmental performance and improve their action, not only on climate and environmental concerns, but also on FP.

Comparing 882 banks in developed and developing countries, Buallay et al. (2020) found that ESG improves banks' accounting and market-based performance in developed countries, supporting value creation theory; and that ESG weakens banks' performance in developed and developing countries. Interestingly, some research results

(Matuszak & Rózańska, 2017; Soana, 2011) indicate no significant relationship between ESG disclosure and FP at country level.

## 2.1 | Development of hypotheses

Stakeholder theory explains ESG and shareholder value dynamics (Freeman et al., 2010). Since shareholders are a fundamental element of the interested parties, all decisions must benefit their interests. Consumers' negative decisions about products and services that harm the environment can decrease shareholder value (Eccles et al., 2014).

Banks' commitment to the environment can be determined by analyzing their strategy and using the following indicators: using bank resources in a reasonable manner, managing the risk of lending money to projects that damage the environment, and evaluating companies' financing for environmental risk, as indicated in Jacobs et al. (2010), Gangi et al. (2019), Laguir et al. (2018), Gunawan et al. (2022) and Ben Lahouel et al. (2022). Along these lines, Miralles-Quirós et al. (2019b) affirmed that most banks in Europe contribute to reducing environmental problems by reducing electricity use, using renewable energy, and evaluating policies related to environmental address. Crespi and Migliavacca (2020) found that financial companies' ESG scores are rising in a linear trend over time, and that this trend is reinforced by their size and profitability, as is the economic and social development of the country in which they operate. Further, greater environmental disclosure would increase financial companies' profitability. Buallay (2019) found that environmental activities had a positive effect on ROA and TQ. Kartadjudena and Rodgers (2019) found that climate and environmental concerns have a significant negative impact on both financial health and market value performance in Indonesian banks.

Some research found, however, that environmental activities had no impact on banks' performance. For example, Forgione et al. (2020) determined that environmental activities reduce bank efficiency, and analysis by Dell'Atti et al. (2017) of the relationship between bank reputation and economic performance after the 2008 mortgage crisis found that environmental activities had no impact on bank performance.

Based on previous theoretical and empirical research, we advance the following hypotheses.

**H1.** ESG data disclosure is positively correlated with banks' PF.

Under the previous assumptions, disaggregation of an ESG and FP proxy is assumed. Hypotheses H2a, H2b, and H2c are proposed as constituents of each hypothesis formulated (H2, H3, and H4):

**H2.** There is a relationship between Southeast Asian banks' environmental activities and their FP.

**H2a.** There is a relationship between environmental activities and bank FP as measured by ROA.

**H2b.** There is a relationship between environmental activities and bank FP as measured by ROE.

**H2c.** There is a relationship between environmental activities and bank FP as measured by TQ.

The information on social activities disclosed depends on each company's characteristics. For example, several studies performed in developed countries such as the US, Canada, and some European countries showed a negative association between FP and banks' social activities due to higher social costs that exceed the benefits the banks obtained (Buallay, 2019; Di Tommaso & Thornton, 2020; Miralles-Quirós et al., 2019a, 2019b). The social impact hypothesis derived from stakeholder theory expects an increase in CSR level to be strongly associated with increase in FP (Wu et al., 2017; Wu & Shen, 2013).

Companies with high sustainability are also more likely to have established processes for stakeholder engagement, to be more long-term oriented, and to measure and disclose more non-financial information (Eccles et al., 2014). Some research obtains mixed results, however, for the relationship between sustainability, social responsibility, and FP. For example, Velte (2017), Wu et al. (2017), Atan et al. (2018), and Gao and Wan (2023) found a positive relationship between CSR and FP. Dell'Atti et al. (2017) determined that social activities are positively related to the company's reputation and have the potential to improve its FP. Aras et al. (2018) argue that healthy banking will drive a strong economy and obtain a significant and positive relationship between sustainability practices, FP, and long-term market value in banks in Turkey.

Based on prior theoretical and empirical research, we hypothesize that:

**H3.** There is a relationship between Southeast Asian banks' social activities and their FP.

**H3a.** There is a relationship between social activities and bank FP as measured by ROA.

**H3b.** There is a relationship between social activities and bank FP as measured by ROE.

**H3c.** There is a relationship between social activities and bank FP as measured by TQ.

According to agency theory, better corporate governance contributes to better performance of value chain structures and increases profitability (Youssef & Diab, 2021). Problems can arise, however, from a conflict of interest and/or asymmetry of information among the interested parties. Good corporate governance is one way to align the interests of shareholders and management to improve company performance (Forgione et al., 2020). Companies with poor corporate governance will develop serious problems of agency, which can lead to low profitability (Miras-Rodríguez et al., 2015; Ullah & Nasim, 2021).

Previous research has shown varying results on the relationship between corporate governance and bank performance (Anginer et al., 2018; Aslam & Haron, 2020; Buallay, 2019; El Khoury et al., 2021; Ghosh, 2017; Harkin et al., 2020; Maxfield et al., 2018; Nawaz, 2017; Nobanee & Ellili, 2022). Miralles-Quirós et al. (2019b) analyzed the association between ESG and bank performance in the US and Europe and found that both investors value each of the three ESG pillars differently and that governance has a positive influence on market value and Earning Per Share. Evaluating the relationship between bank board membership and ESG performance, Birindelli et al. (2018) found a positive link between ESG performance and composition of the board of directors (men and women), board size, and presence of a CSR committee. Along the same lines, (Ellili, 2023) studied the impact of corporate governance on the ESG of financial and non-financial companies and concluded that ownership structure and the board of directors played an important role in increasing ESG disclosure.

Other research shows the negative effects of governance on bank performance. Examining the relationship between ESG activities in banks in 40 emerging economies during 2011–2017, Azmi et al. (2021) found that governance had a negative effect on banks' value. Studying banking companies listed on the Indonesian Stock Exchange, Mukhtaruddin et al. (2019) found that good corporate governance has a negligible positive effect on company value and strengthens FP. Buallay (2019) argues, however, that governance has a negative impact on European banks' FP.

Based on prior theoretical and empirical research, we hypothesize that:

**H4.** There is a relationship between Southeast Asian banks' governance activities and their FP.

**H4a.** There is a relationship between governance activities and bank FP as measured by ROA.

**H4b.** There is a relationship between governance activities and bank FP as measured by ROE.

**H4c.** There is a relationship between governance activities and bank FP as measured by TQ.

### 3 | RESEARCH METHODOLOGY

To achieve our research objectives and answer the questions raised, we conducted an exploratory, descriptive, and inferential study. The methods include panel data analysis (ESG data from Thomson Reuters), statistical correlations, and regression models.

#### 3.1 | Sample and data selection

To obtain a sample of banks in Southeast Asia for the period 2010–2020, we first identified the banking population of the five countries

(Indonesia, Malaysia, Singapore, Thailand, and the Philippines). We then ensured that all banks were active and did not merge during the observation period. We also established that all banks submitted their financial statements during the observation period and that each bank's ESG data appeared in the Thomson Reuters database. Thomson Reuters has been widely used as a source of ESG data in previous studies, such as Cheng et al. (2014), El Ghoul et al. (2017), Gangi et al. (2019), and Al-Shaer and Hussainey (2022).

From the full list of banks provided by Thomson Reuters, we excluded banks whose environmental information did not contract for one or more fiscal years between 2010 and 2020. We thus obtained a total of 19 banks and 209 observations during 2010–2020 (Table 1).

#### 3.2 | Variable measurement

This study uses ESG data from Thomson Reuters, a reputable global databank with one of the most comprehensive ESG datasets and over 450 historically available distinct ESG variables. Commonly used by researchers, the database's official website provides a clear robust methodology for ESG data. Although previous studies of the banking sector have used the Refinitiv database (Esteban-Sanchez et al., 2017; Gangi et al., 2019; Menicucci & Paolucci, 2022; Miralles-Quirós et al., 2019a; Shakil et al., 2019), ours is to the best of our knowledge the first to examine all three pillars of ESG performance in the South-east Asian banking sector. In other words, we measure banks' sustainability using a TBL approach, a method that defines a company's sustainability through a process with three elements: environmental, social, and economic/governance.

#### 3.3 | Independent variables of the three pillars of ESG and dependent variables

This study uses ESG as an independent variable, in accordance with previous research (Buallay, 2019; Esteban-Sanchez et al., 2017; Menicucci & Paolucci, 2022; Peni & Vähämaa, 2012; Shakil et al., 2019). We include environmental activities (ENVI), social activities (SOC), and governance activities (GOV), as defined in Table 2. This study uses three main indicators to measure FP as dependent variable: ROA to measure banking operational performance, ROE to

**TABLE 1** Sample description.

Countries	Number of banks	Number of observations
Indonesia	5	55
Malaysia	6	66
Singapore	2	22
Thailand	3	33
Philippines	3	33
Total	19	209



**TABLE 2** Explanations of variables.

Variables	Labels	Formula
<i>Independent variables</i>		
Environmental, social, and governance	ESG	Thomson Reuters (TR) Index: Combines ESG activity disclosure indexes
Environmental activities	ENVI	TR Index: Measures banks' disclosure of energy use, waste, pollution, natural resource conservation, and animal treatment
Social activities	SOC	TR Index: Measures disclosure on workforce, community, product responsibility, bank effectiveness toward job satisfaction, and safe and healthy workplace, while developing both equal and diversity opportunities
Governance activities	GOV	TR Index: Consists essentially of balancing the interests of a company's many stakeholders and CSR strategy
<i>Dependent variables</i>		
Return on Assets	ROA	Net income after taxes divided by average total assets
Return on equity	ROE	Net income after taxes divided by average total equity
Tobin's Q	TQ	Market value of equity and total book value of liabilities, divided by total book value of assets
<i>Control variables</i>		
Size	SZ	Natural logarithm of total assets
Leverage	LEV	Total Leverage Formula = Total Debt/Shareholder's Equity

measure banking FP, and TQ to measure banking market value. This approach also follows previous research (Albertini, 2013; Buallay, 2019; Buallay et al., 2020; Chowdhury et al., 2017; Esteban-Sanchez et al., 2017; Mayur & Saravanan, 2017; Nizam et al., 2019). We use two control variables: size (SZ) and leverage (LEV). SZ is measured using the natural logarithm of total assets (Buallay, 2019; Nizam et al., 2019; Platonova et al., 2018; Velte, 2017). LEV is measured using the company's total debt (Buallay, 2019; Nizam et al., 2019; Shen et al., 2016).

### 3.4 | Empirical model

We analyze the statistical connections and associations between ESG and FP in Southeast Asian banks to test the hypotheses using panel data techniques and the EViews statistical tool. Techniques for panel data modeling have been widely used in numerous FP banking studies (Buallay et al., 2021; Chang & Devine, 2019; Esteban-Sanchez et al., 2017; Shakil et al., 2019; Shen et al., 2016; Siueia et al., 2019).

Based on the studies cited above, this analysis uses econometric equations with the following multiple regression models:

$$FP_{it} = \beta_0 + \beta_1 ESG_{it} + \beta_2 SIZE_{it} + \beta_3 LEV_{it} + e_{it} \text{ (Model 1)}$$

$$FP_{it} = \beta_0 + \beta_1 ENVI_{it} + \beta_2 SOC_{it} + \beta_3 GOV_{it} + \beta_4 SIZE_{it} + \beta_5 LEV_{it} + e_{it} \text{ (Model 2)}$$

Two models are proposed, the first to analyze the relationship between ESG and the Southeast Asian banks' FP, and the second to analyze in depth the relationship between the three ESG pillars and these banks' FP. In the first model, ESG as an independent variable represents the index of total disclosure of environmental, social, and governance activities. The dependent variable is FP, divided into three proxies (ROA, ROE, and TQ), " $\beta_0$ " is the constant, and " $\beta_{1-5}$ " is the slope of the controls and independent variables.

The second model uses ESG pillars as an independent variable measured by three pillars (ENVI, SOC, and GOV). The controls variables are SZ, total assets, and LEV. " $e$ " is the random error, " $i$ " the bank, and " $t$ " the period. While we propose only one research model, we divide this model into three parts when conducting regression testing because the dependent variable FP has three indicators—ROA, ROE, and TQ.

This research uses panel data that combine cross-sectional and time series data. Before performing the regression tests, we selected the best of the three possible models, a Common Effects Model (CEM) using Ordinary Least Squares (OLS), a Fixed Effects Model (FEM) using the Least Square Dummy Variable (LSDV) approach, and a Random Effects Model (REM) using Generalized Least Square (GLS), in line with Weber (2017), Platonova et al. (2018), Maqbool and Zameer (2018), and Siueia et al. (2019). We also performed various statistical tests. The Chow Test was used to choose between CEM and FEM, the Hausman Test to choose between the FEM and REM, and the Lagrange Multiplier Test to choose between CEM and REM. If the  $p$ -value > 5%,  $H_0$  is accepted; if the  $p$ -value < 5%,  $H_1$  is accepted. Deciding between CEM, FEM, and REM provides the benefit of avoiding problems of heterogeneity when analyzing long-term data (Issa et al., 2021).

## 4 | RESULTS AND DISCUSSION

### 4.1 | Descriptive statistics for all variables

To answer RQ1, the results of the descriptive statistics show the level of reporting on ESG activities presented by Southeast Asian banks in each of the three pillars.

Table 3 presents the descriptive statistics for all variables. For the ESG variable, three countries out of five present scores above 50 out of 100. The highest score is 88 out of 100 and the lowest.

14, indicating much room for improvement in Southeast Asian banks' ESG reporting. High standard deviations are also observed, indicating highly dispersed data that extend over a range of values wider than the mean.

The level of disclosure of ESG activities in Indonesia is higher than in other Southeast Asian countries. This is because Indonesia is

**TABLE 3** Descriptive statistics of the variables: Panel data for the period 2010–2020.

Variables	N	Mean	S.D.	Max.	Min.	Variables	N	Mean	S.D.	Max.	Min.
ESG						ROA					
Indonesia	55	59.30	12.94	88	30	Indonesia	55	2.43	0.73	3.66	0.38
Malaysia	66	48.86	17.42	84	17	Malaysia	66	1.15	0.21	1.56	0.72
Singapore	22	52.18	18.82	76	19	Singapore	22	1.01	0.17	1.49	0.69
Thailand	33	54.58	15.42	84	22	Thailand	33	1.35	0.37	2.18	0.5
Philippines	33	40.15	12.22	62	14	Philippines	33	1.52	0.80	4.58	0.57
ENVI						ROE					
Indonesia	55	40.61	21.76	79	10	Indonesia	55	17.74	7.51	35.89	2.29
Malaysia	66	36.39	22.23	80	4	Malaysia	66	12.83	3.98	25.63	6.96
Singapore	22	47	27.94	93	15	Singapore	22	11.08	2.31	17.83	6.22
Thailand	33	52.39	23.98	89	15	Thailand	33	12.01	4.12	21.84	3.92
Philippines	33	23.94	14.49	53	5	Philippines	33	12.30	5.92	33.79	3.22
SOC						TQ					
Indonesia	55	61.16	18.28	94	22	Indonesia	55	1.12	0.11	1.40	0.94
Malaysia	66	50.79	21.06	86	9	Malaysia	66	1.04	0.05	1.16	0.94
Singapore	22	52.64	18.34	82	22	Singapore	22	1.02	0.01	1.04	0.99
Thailand	33	58.85	21.25	91	21	Thailand	33	1.04	0.06	1.18	0.94
Philippines	33	37.67	17.62	70	4	Philippines	33	1.05	0.05	1.15	0.95
GOV						SIZE					
Indonesia	55	68.70	13.13	90	34	Indonesia	55	51.093	3.860	75.780	34.319
Malaysia	66	57.42	20.75	92	18	Malaysia	66	67.584	2.862	80.884	46.582
Singapore	22	60.32	21.03	88	20	Singapore	22	292.954	19.193	409.474	193.952
Thailand	33	53.64	16.02	82	19	Thailand	33	73.520	5.531	107.752	47.71915.697
Philippines	33	55.61	17.34	86	27	Philippines	33	30.210	2.958	45.010	
						LEV					
						Indonesia	55	43.837	3.108	64.736	3.663
						Malaysia	66	61.498	2.436	72.460	43.115
						Singapore	22	217.423	13.472	295.770	149.805
						Thailand	33	64.936	4.767	94.978	42.326
						Philippines	33	20.650	1.921	29.893	11.088

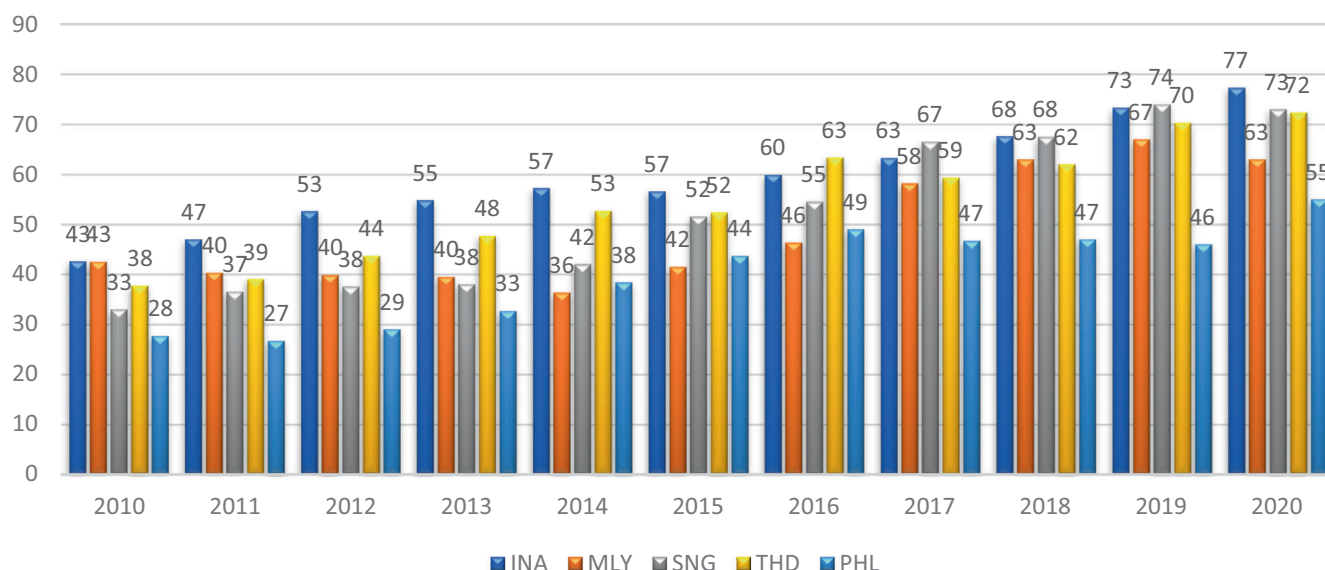
Abbreviation: S.D., standard deviation.

economically better off than other countries, as seen from the total value of banking assets—the second largest among Southeast Asian countries. In addition, in terms of regulation, Indonesia has since 2017 required companies that go public to publish sustainability reports. The individual pillar analyses for the ENVI pillar show that only Thai banks achieve a mean of 52.39 points out of 100, with high standard deviations both in the country sample and between countries. For the SOC pillar, four countries' banks present average scores above 50 points. For the GOV pillar, however, banks in all five Southeast Asian countries achieve average information levels above 50 points, with Indonesia scoring a striking average of 68.70 points. Of the results for the three ESG pillars, therefore, ENVI is the pillar least reported by banks in Southeast Asia. We thus infer that these banks generally focus more on management and supervision, shareholder

rights, and CSR strategy in terms of human resources (both workers and clients), while their ENVI (derived from investments they finance) are less present in their organizational culture. These results are in line (Kumar & Prakash, 2020), who indicated that banks respond slowly to sustainability problems.

The results for FP with ROA, ROE, and TQ indicators show that Indonesia scores high in all areas of FP (mean values of 2.43, 17.74, and 1.12, respectively). Singapore is the country with the largest total assets and leverage banking in the Southeast Asian region (mean values 292.954 and 217.423).

To answer RQ 1, Figure 1 shows the level of information ESG for Southeast Asian countries during the period 2010–2020. The figure shows that the levels of ESG information have increased each year in each country. This result is in line with (Bose & Khan, 2022), who



**FIGURE 1** Level of ESG information.

show that countries in Southeast Asia have experienced rapid disclosure of their non-financial reports. This is because they recognize that decision-makers such as the board of directors increasingly understand and care about their companies' sustainability through environmental and social activities (Sekarlangit & Wardhani, 2022).

More specifically, Indonesia is the country with the highest level of ESG information in 2010. Indonesia's ESG information score in 2020 increased from 43% to 77%, probably because the Indonesian government has since 2017 required every company that are listed on the stock exchange to make a sustainability report.

Singapore and Malaysia have also seen a significant increase in ESG reporting levels, reaching 73% and 72%, respectively. Thailand and the Philippines have increased their information levels, although to a lesser extent.

## 4.2 | ESG difference test between countries. Robustness tests results

The Kruskal–Wallis test was used to determine significant differences in the median between the independent variables, namely the five countries in Southeast Asia (Indonesia, Malaysia, Singapore, Thailand, and the Philippines) and whose results are presented in Table 4.

The test detected significant differences in ESG disclosures from the five countries, as can be seen from the significance value of  $0.000 < 5\%$ . This result aligns with testing through ESG pillars, which shows differences in ENVI, SOC, and GOV disclosures among the five countries (sig. values 0.000, 0.000, and  $0.001 < 5\%$ , respectively). The differences in ESG practices among countries are influenced by each country's unique characteristics, such as economic level, GDP, security factors, and sustainability policies (M. H. Ali et al., 2022). In addition, company characteristics such as company size and amount of debt can affect ESG practices (Buallay et al., 2023).

**TABLE 4** Kruskal–Wallis test.

	ESG	ENVI	SOC	GOV
Chi-Square	31.200	28.699	26.867	18.817
df	4	4	4	4
Asymp. Sig.	0.000*	0.000*	0.000*	0.001*

Note: Significant at \*5%.

## 4.3 | Correlation results

The results of the descriptive statistics show that the assumption of normality is not met for distribution of the values. We, therefore, calculated the Spearman correlations to observe the relationships among all variables. Table 5 displays the correlation coefficients between the variables in the regression model separately for each ESG pillar.

The results of the correlations show that the FP variables (ROA, ROE, TQ) correlate closely with each other, indicating a relationship between the independent variables (ESG, ENVI, SOC, GOV) and the dependent variables (ROA, ROE, TQ). ESG does not correlate with ROA (sig. value  $0.80 > 5\%$ ) but rather correlates negatively with ROE and TQ (sig. values 0.007;  $0.047 < 5\%$  and correlation values  $-0.186$ ;  $-0.138$ ). Suggesting that ESG activities correlate inversely with ROE and TQ, this result agrees with those of Soana (2011) and Matuszak and Rózańska (2017), who find no significant relationship between disclosure of ESG information and FP at country level. Other researchers (Buallay, 2020; Cornett et al., 2016; Friede et al., 2015; Wu & Shen, 2013) obtain a positive relationship between ESG and FP.

The ESG pillars are related to some dependent variables of FP but not interrelated with each other, except for the ENVI pillar scores, which correlate with those of the pillars SOC and GOV. ENVI does not correlate with ROA, ROE, or TQ (sig. values 0.843; 0.897;



**TABLE 5** Correlation test (Spearman) and multicollinearity test.

	ESG	ENVI	SOC	GOV	ROA	ROE	TQ	SZ	LEV
ESG									
Correlation		0.695**	0.901**	0.596**	0.121	0.186**	0.138**	0.577**	0.564**
Sig. (2-tailed)		0.000	0.000	0.000	0.80	0.007	0.047	0.000	0.000
ENVI									
Correlation			0.642**	0.221**	−0.014	0.009	−0.064	0.554**	0.551**
Sig. (2-tailed)			0.000	0.001	0.843	0.897	0.360	0.000	0.000
SOC									
Correlation				0.266**	0.071	0.197**	−0.177*	0.583**	0.573**
Sig. (2-tailed)				0.000	0.306	0.004	0.010	0.000	0.000
GOV									
Correlation					0.192**	−0.101	−0.022	0.215**	0.204**
Sig. (2-tailed)					0.005	0.145	0.747	0.002	0.003
ROA									
Correlation						0.538**	0.453**	−0.061	−0.075
Sig. (2-tailed)						0.000	0.000	0.379	0.281
ROE									
Correlation							0.539**	−0.042	−0.039
Sig. (2-tailed)							0.000	0.541	0.575
TQ									
Correlation								−0.098	−0.090
Sig. (2-tailed)								0.156	0.194
SZ									
Correlation									0.653**
Sig. (2-tailed)									0.000
LEV									
Correlation									
Sig. (2-tailed)									

Note: Correlation is significant at \*5%, \*\*1%.

0.360 > 5%). This finding suggests that ENVI has no impact on banks' profitability relative to their total assets (ROA), a result that aligns with some previous literature (Dell'Atti et al., 2017; Forgione et al., 2020) and contrasts with the results of Buallay (2019) and Crespi and Migliavacca (2020). SOC correlates negatively with ROE and TQ (sig. 0.004; 0.010 < 1% and correlation values −0.197; −0.177), indicating that greater commitment to SOC decreases ROE and the intrinsic value of the banks' shares according to H3b and H3c and previous literature (Buallay, 2019; Di Tommaso & Thornton, 2020; Miralles-Quirós et al., 2019a, 2019b). GOV correlates positively with ROA (sig. value of 0.005 < 1% and correlation value of 0.0192), while GOV does not correlate with ROE or TQ (sig. values 0.145; 0.747 > 5%). These results suggest that higher quality of corporate governance increases with ROA, supporting H4a and previous literature (Aslam & Haron, 2020; Menicucci & Paolucci, 2022). The results show no problems of multicollinearity between any of the independent variables, with the connection value of each variable <0.9.

#### 4.4 | Regression results for ESG variables (model FEM 1)

Before the regression tests, we had selected FEM as the best model for the three FP indicators (ROA, ROE, TQ), considering the probability values of the Hausman test (0.0000; 0.000; 0.000), all three of which were <5%. We also verified the absence of heteroskedasticity problems using the White test (see Table 6, probability values of 0.0650; 0.3041; 0.0650 < 5%).

The results of the regression test show that ESG has a negative effect on ROA, ROE, and TQ ( $p$ -values of 0.014; 0.025; 0.0148 < 5% and coefficients of −0.0953; −0.0489; −0.0095).

Thus, when a bank invests its resources in SOC, is concerned about the environment, and has good governance, its profitability changes in the opposite direction (drops). These results align with the findings of other studies (Buallay, 2019; Buallay et al., 2020; Duque-Grisales & Aguilera-Caracuel, 2021; Esteban-Sanchez et al., 2017). In other words, ESG activities generate significant

costs in the short term, due to the use of many financial and organizational resources, which reduce returns. When implementing ESG practices for the first time, therefore, the bank should develop a plan to ensure that good ESG practices have a positive impact on the bank's FP.

#### 4.5 | Regression result for ESG pillars (model FEM 2)

The same occurs as in Model FEM 1. We tested the models to determine which performed better. As the Hausman test shows that the probability values for the three FP indicators (ROA, ROE, TQ) are (0.0000; 0.0000; 0.0002) < 5%, we chose the FEM. We verified the absence of heteroskedasticity problems through the probability values of the White Test for all variables (see Table 7, probability values of 0.9849; 0.1518; 0.2392) < 5%.

The regression results show that ENVI has a positive effect on ROA ( $p$ -value of  $0.07 < 10\%$  and coefficient value 0.0032). We, therefore, accept H2a, in line with the previous results of Velte (2017). Banks that develop a sustainable finance policy and invest in products obtain positive returns on these investments or green assets. ENVI, in contrast, has no effect on ROE and TQ, with a  $p$ -value (0.56; 0.39) > 10%, rejecting H2b and H2c. This result contrasts with previous research (Crespi & Migliavacca, 2020). In other words, the environmental policies of banks in Southeast Asia do not seem to benefit shareholders and investors (ROE) or firm value (TQ).

SOC has no effect on ROA and ROE, with a  $p$ -value (0.17; 0.15) > 10%, leading us to reject H3a and H3b. This result aligns with existing research (Atan et al., 2018; Esteban-Sanchez et al., 2017; Menicucci & Paolucci, 2022; Wu et al., 2017), showing that stakeholders do not care much about the SOC of banks in Southeast Asia. SOC does, however, have a negative effect on TQ ( $p$ -value of  $0.02 < 5\%$  and coefficient value of  $-0.000766$ ). We, therefore, accept

Variable	(1) ROA Coeff. (p-value)	(2) ROE Coeff. (p-value)	(3) TQ Coeff. (p-value)
<i>Independent variables</i>			
ESG	−0.0953** (0.014)	−0.0489** (0.025)	−0.0095* (0.0148)
<i>Control variables</i>			
Ln SZ	−1.0882 (0.000)	−53.7576 (0.000)	−1.0882 (0.000)
Ln LEV	−1.0653 (0.000)	46.9093 (0.002)	1.0653 (0.000)
Adj R-squared	0.5644	0.7563	0.5644
Prob (F-statistic)	0.00000	0.00000	0.00000
Prob (Hausman Test)	0.0000	0.0000	0.0000
Prob (White Test)	0.0650	0.3041	0.0650
Model	Fixed Effect	Fixed Effect	Fixed Effect

Note: Significant at  $p$ -value \* < 1%; \*\* < 5%; \*\*\* < 10%.

**TABLE 6** Regression. Fixed effects model ((Model FEM 1).

Variable	(1) ROA Coeff. (p-value)	(2) ROE Coeff. (p-value)	(3) TQ Coeff. (p-value)
<i>Independent variables</i>			
ENVI	0.0032*** (0.07)	0.0083 (0.56)	0.00021 (0.39)
SOC	−0.0036 (0.17)	−0.0304 (0.15)	−0.000766** (0.04)
GOV	−0.0007 (0.71)	−0.0275* (0.07)	−0.000595** (0.02)
<i>Control variables</i>			
Ln SZ	2.1315 (0.17)	−55.3532 (0.00)	−1.0951 (0.00)
Ln LEV	−2.8036 (0.07)	48.4828 (0.000)	1.0777 (0.000)
Adj R-squared	0.761	0.755	0.5717
Prob. (F-statistic)	0.0000	0.00000	0.00000
Prob. (Hausman Test)	0.0000	0.0000	0.0002
Prob. (White Test)	0.9849	0.1518	0.2392
Model	Fixed Effect	Fixed Effect	Fixed Effect

Note: Significant at  $p$ -value \* < 1%; \*\* < 5%; \*\*\* < 10%.

**TABLE 7** Regression. Fixed effect model (Model FEM 2).

H3c, a finding supported by previous research (El Khoury et al., 2021). In other words, bank investment in SOC will increase reputation and profitability in the short term but may hurt the profitability and value of banks in Southeast Asia in the long term.

GOV has a negative effect on ROE and TQ, with a  $p$ -value  $(0.07; 0.02) < 5\%$  and a coefficient value  $(-0.0275; -0.000595)$ . We thus accept H4b and H4c, a finding supported by some previous research (Azmi et al., 2021; Buallay, 2019; Miralles-Quirós et al., 2019a). As GOV has no effect on ROA ( $p$ -value  $0.71 > 10\%$ ), we reject H4a, whereas Qureshi et al. (2020) show that corporate governance has no effect on corporate value and El Khoury et al. (2021) argue that over-investment in GOV reduces the value of the company itself.

## 5 | CONCLUSIONS, IMPLICATIONS, AND RESEARCH LIMITATIONS

As detailed in the literature review, numerous studies highlight that banks must, within the framework of risk management, consider the ESG information disclosed in their sustainability reports to complement their risk reports. In addition to regulatory pressures for banks to submit sustainability reports and increased demand for sustainable products from investors, consensus argues that stakeholders should view financial institutions as entities committed to ESG values. After the financial crisis, regaining customer trust was a significant factor in the development of ESG practices in credit institutions.

The literature review identifies several previous studies that analyze the relationship between ESG and banking FP in developed and emerging countries. Our study analyzes the relationship between ESG and bank FP using Thomson Reuters ESG data for 2010–2020 for banks in Southeast Asia. Our in-depth examination of ESG divides it into three pillars (environmental, social, and governance) to determine which specific pillars have a significant effect on FP in banking across Indonesia, Malaysia, Singapore, Thailand, and the Philippines.

Our descriptive analysis reveals that banks' ESG scores in Southeast Asian countries are on average around 50 points out of 100. There is thus much room for improvement in Southeast Asian banks' ESG reporting. The highest average scores for the ESG pillars are GOV, followed by SOC. ENVI, in contrast, scores very low, except in Thailand, which achieves a medium-level score, indicating that ENVI in banks in the Southeast Asia region does not receive enough attention. The results of the robustness tests confirmed differences in ESG disclosures among the five countries analyzed and attributed these differences to the characteristics of each country. This result confirms the findings of Ali et al. (2022).

Our research results show that ESG has a significant negative effect on FP (ROA, ROE, TQ). These results are in line with the findings of other studies (Buallay, 2019, 2020; Duque-Grisales & Aguilera-Caracuel, 2021; Esteban-Sanchez et al., 2017). Thus, if banks use their resources in SOC, are concerned about the environment, and have good governance, their short-term profitability decreases due to increased costs (financial and organizational resources) in ESG practices. This result shows that ESG activities in banks in developing

countries must be carefully managed by management so that they are not perceived as negative by stakeholders and thus create a culture of sustainability that assumes lower upfront costs as a long-term investment.

Interestingly, in-depth testing by combining ESG into several pillars (environment, social, and governance) showed varied results. ENVI has a positive effect on ROA, in line with the previous results of Velte (2017), but does not affect ROE and TQ, in agreement with the results of (Crespi & Migliavacca, 2020).

SOC has no influence on ROA and ROE but affects TQ negatively. This result aligns with existing research (Atan et al., 2018; Esteban-Sanchez et al., 2017; Menicucci & Paolucci, 2022; Wu et al., 2017). GOV negatively affects ROE and TQ, a finding supported by some previous research (Azmi et al., 2021; Buallay, 2019; Miralles-Quirós et al., 2019a), but does not affect ROA. In line with Qureshi et al. (2020), our results show that corporate governance has no effect on corporate value. Further, El Khoury et al. (2021) argue that over-investment in GOV reduces firm value.

Our study also shows differences in the level of ESG information in each country that can be explained by the economic characteristics of each country, including the specific policies of each country that affect its financial system.



These findings align with stakeholder theory, which argues that good governance activities for banks' customers, suppliers, and employees strongly impact the bank's profitability and market value. Although stakeholders or investors may lack awareness of financial activities' short-term impact on the environment, we believe that banks' environmentally conscious actions will increase their competitive advantage (corporate image, corporate awareness, intangible assets, etc.) in both the short and the long term. From a governance perspective, there is no doubt that investors greatly appreciate banks with quality governance. If banks are high-risk companies, high quality governance is imperative.

This study has significant implications for stakeholders, ESG policymakers, and academics. For stakeholders, it clarifies the relationship between ESG disclosure in sustainability reports and the FP of Indonesian banks. For investors, it reveals that relating sustainability reports to FP helps to reduce risks for banks. For policymakers, the results provide new information on the impact and credibility of banks' sustainability reports, improving understanding of how and why organizations modify their sustainability practices. For academics, the study contributes to an emerging body of literature aligned with sustainability reporting. From a practical perspective, the results advance understanding of financial institutions' commitment to sustainability and the credibility of transparent reliable ESG reporting efforts.

For stakeholders, the study demonstrates a relationship between ESG and FP, although this relationship is negative. The average score indicates that banks' ESG and specific ESG pillar activities are still far from optimal. Management must focus more on environmental conditions, social contributions, and corporate governance to achieve a positive impact on profitability and company value in the long run. Finally, for policymakers, our research provides insights into which ESG pillars banks address most.

Nevertheless, this paper's conclusions must be viewed with caution due to the study's inherent limitations. The main limitation of the research is the limited availability of ESG data on all banks in South-east Asian countries. The Thomson Reuters database does not include data from all countries in the region and only includes ESG data from the largest banks in five countries. Therefore, caution should be taken when generalizing our conclusions, due to the small sample size. Many future research opportunities remain to enrich understanding of the relationship between ESG and FP. Subsequent studies could contribute to the literature by adding moderating variables (e.g., CEO structure, corporate reputation, impact of the COVID-19 phenomenon) to determine the impact of the relationship between ESG and company performance.

# ORCID

Herenia Gutiérrez-Ponce  <https://orcid.org/0000-0002-4894-7039>  
Sigit Arie Wibowo  <https://orcid.org/0000-0003-4051-6522>

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