

The Impact of ESG Pillars on Banking Financial Performance in ASEAN-5 Countries

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ABSTRACT

Purpose: This research analyzes the effect of ESG pillars on the financial performance (ROA) of banking companies in ASEAN-5 countries.

Method: The study utilizes ESG data sourced from Thomson Reuters Eikon Refinitiv. The research population comprises 91 banks from ASEAN-5 countries, with a sample size of 25 banks selected for analysis. The observation period spans 2019 to 2023. Panel data regression analysis was conducted using Eviews 12 software to evaluate the data.

Result: The findings reveal that, during the 2019–2023 period, the environmental and social pillars of ESG do not significantly impact the ROA of banking companies in ASEAN-5. However, the governance pillar demonstrates a significant positive relationship with ROA, indicating that corporate governance practices play a key role in enhancing the financial performance of banks in the region.

Practical Implications for Economic Growth and Development: This study contributes to economic growth and development by emphasizing the critical role of corporate governance in improving the financial performance of banking firms in ASEAN-5. The findings suggest that robust governance practices can boost operational efficiency, attract investment, and enhance financial stability—factors essential for sustainable economic growth. Policymakers can leverage these insights to design targeted incentives that encourage banks to strengthen their governance frameworks, fostering a more resilient banking sector in Southeast Asia.

Keywords: *banking, ESG disclosure, sustainability reporting, profitability*

INTRODUCTION

Sustainable Development Goals (SDGs) have emerged as a global initiative over the past few decades. These goals aim to create a better quality of life for humanity by addressing social and economic development while emphasizing environmental responsibility, a shared obligation among all stakeholders, including companies. To support the SDGs, companies can enhance their Environmental, Social, and Governance (ESG) performance (Nareswari et al., 2023). ESG has become a key non-financial factor in evaluating how companies implement the SDGs (Saini et al., 2022). According to Buallay (2020), ESG—often highlighted in sustainability reports—is no longer just a passing trend but an essential component of modern business strategies. The three pillars of ESG are interconnected, directly or indirectly influencing a company's overall performance (López-Toro et al., 2021). ESG reports serve as vital communication tools, signaling a company's commitment to sustainability and transparency. This commitment, in turn, enhances the company's reputation and financial performance (Tarmuji et al., 2016). Therefore, ESG has become integral to achieving long-term corporate success (Alareeni & Hamdan, 2020).

The banking sector plays a critical role in the financial industry, particularly in the collection and distribution of funds within an economy. Consequently, decisions made by banks regarding fund allocation are crucial, as these decisions can significantly impact both the environment and society (Nurhalida & Shofwan, 2023). Banks, therefore, have a substantial role in environmental protection, not only through their operations but also by influencing the



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activities of their clients and borrowers. ESG practices in companies based in ASEAN have increased, driven by growing concerns about carbon emissions and widespread deforestation (Estoque et al., 2019). This improvement is also attributed to stricter regulations in individual countries, along with international financial systems and supply chains that demand transparency and sustainability. In this context, ESG has become a particularly important consideration in the banking sector, given its central role in the economy.

Despite the rapid growth of ESG adoption, research on its impact in Southeast Asia—especially within the banking sector—remains limited. Studies investigating ESG factors in the region face challenges stemming from cultural differences, varying levels of development, population sizes, predominant religions, and diverse legal environments (Chapple & Moon, 2005). These complexities make it difficult to evaluate the quality and transparency of ESG reports from companies in Southeast Asia. While the ASEAN-5 countries boast a combined GDP of USD 3.17 trillion, making them the fifth-largest economy globally, ESG reporting has not been consistently implemented across all ASEAN nations. This inconsistency provides an ideal context for studying ESG factors in the region.

Recent studies indicate that businesses have improved their ESG performance in recent years, largely aiming to enhance financial outcomes (Wu et al., 2024). However, critics such as Friedman (2007) argue that the high costs associated with ESG initiatives could negatively impact financial performance, particularly for companies in environmentally sensitive sectors. Research by Gholami et al. (2022) supports this perspective, suggesting that the financial impact of ESG initiatives varies depending on the industry in which a firm operates. Numerous studies have explored the link between ESG and financial performance, especially in developing nations, but the findings are often inconsistent and, at times, contradictory (Brooks & Oikonomou, 2018). One primary reason for these discrepancies is the variation in ESG characteristics across different sectors (Buallay, 2022). The banking sector, in particular, has been slower than other industries in addressing sustainability issues (Jeucken & Bouma, 1999). Despite increased attention to ESG within the financial services sector, banks still lag in managing their social and environmental impacts (Buallay, 2020).

This study aims to address gaps in the existing literature by focusing on the ASEAN-5 region, where ESG practices and their financial implications, particularly in the banking industry, remain under-researched. Specifically, the study examines how the three ESG pillars influence financial performance, particularly Return on Assets (ROA), in the ASEAN-5 banking industry. While previous research has investigated ESG across various industries globally, this study's regional focus considers the unique cultural, economic, and legal contexts of ASEAN-5 countries. Limited research currently exists on how ESG factors affect financial performance in Southeast Asian banking institutions, making this study a valuable contribution to understanding this relationship.

Given the distinctive challenges and characteristics of the ASEAN region, this study primarily explores the relationship between financial performance and the three ESG pillars within banking institutions in the ASEAN-5 countries, with a specific focus on ROA. By enhancing our understanding of the link between ESG and profitability in the ASEAN banking sector, this study aims to significantly contribute to the growing body of research on ESG.

METHOD

In this study, a quantitative approach was employed to collect and analyze data, aiming to test the conceptual model. The data for the research was sourced from the Thomson Reuters Eikon Refinitiv data center, utilizing ESG and ROA metrics. The sampling process for banks in Southeast Asia between 2018 and 2023 began by identifying the population of ASEAN-5 banks. It was ensured that all banks in the sample were operational and had not undergone mergers during this period. Additionally, it was verified that the selected banks had published financial statements within the specified timeframe and that ESG data for these banks was available in the Thomson Reuters Eikon Refinitiv database.

Using a purposive sampling technique, 25 banks were selected from an initial population of 91 banks across the five ASEAN-5 countries. ESG data provided by Thomson Reuters is measured on a scale ranging from 0 (worst) to 100 (best). The ESG data available in the Thomson Reuters database covers 85% of companies globally, is calculated using 630 metrics, and is supported by the efforts of over 700 researchers to measure and determine ESG scores (Refinitiv, 2022). Several researchers have also utilized ESG data from Thomson Reuters in their studies (Fatemi et al., 2018; Indrasuci & Rokhim, 2023; Kartikasary et al., 2023).

Table 1. Research Samples

Country	Selected Banks	All Banks
Indonesia	5	48
Malaysia	8	12
Singapura	3	3
Filipina	4	13
Thailand	5	15
Total	25	91

Source: Authors' compilation (2024)

The independent variables in this research consist of the scores for the Environmental (ENV), Social (SOC), and Governance (GOV) pillars, as outlined in Table 2. Numerous previous studies have utilized ESG pillars as independent variables (e.g., A. Buallay, 2019; Hwang et al., 2021; Jung & Yoo, 2023; Menicucci & Paolucci, 2023). The dependent variable is the return on assets (ROA), which measures a company's effectiveness in utilizing its assets to generate earnings. ROA, a widely used profitability metric, is calculated by dividing net income by total assets, as described in Table 2. It is particularly suitable for assessing the impact of ESG practices because the implementation of ESG strategies often leads to significant changes in a company's assets (Rahman et al., 2023). Several researchers have employed ROA as a measure of financial performance (e.g., Veeravel et al., 2024).

This study employs panel data regression to explore the correlation between ESG disclosures and the financial performance of banking institutions, using EVIEWS 12 software. The analysis is based on a basic linear regression model, following the approach of Menicucci and Paolucci (2023). The research model is constructed as follows:

$$ROA_{it} = \beta_0 + \beta_1 ENV1_{it} + \beta_2 SOC2_{it} + \beta_3 GOV3_{it}$$

Table 2. Variables Measurement

Variable	Label	Definition
Environmental	ENV	Thomson Reuters (TR) Index: Evaluates banks' reporting on energy consumption, waste management, environmental impact, conservation of natural resources, and animal welfare.
Social	SOC	Thomson Reuters (TR) Index: Measures disclosures related to the workforce, community, product responsibility, and the bank's impact on job satisfaction. It also evaluates initiatives to promote equality and diversity in the workplace and efforts to maintain a safe and healthy work environment.
Governance	GOV	Thomson Reuters (TR) Index: Primarily focuses on balancing the interests of various company stakeholders while integrating effective corporate social responsibility (CSR) strategies.
Return on Assets (ROA)	ROA	Net Profit After Tax (NPAT) / Average Total Assets

Source: Authors' compilation (2024)

Hypotheses Development

Environmental Pillar and Financial Performance

Agency theory highlights the potential conflict of interest between owners and managers. Owners may prioritize short-term profits, while managers often focus on building long-term reputations (Jensen & Meckling, 2012). This misalignment can hinder the adoption of ESG practices, which typically require significant upfront investment. Conversely, compliance theory suggests that external pressures, such as government regulations, may prompt banks to take minimal action, often just enough to meet legal requirements (Milgram, 1963; Hrnjica et al., 2024). Consequently, many banks resort to greenwashing without implementing substantial changes in their operations.

The combination of these theories indicates that ESG implementation in banks may remain suboptimal unless strong incentives are provided for management to commit to sustainable practices. Moreover, adopting sustainable business strategies, particularly those addressing environmental concerns, entails a trade-off between immediate financial performance and long-term sustainability. Significant upfront investments in green technologies can temporarily reduce profitability, especially for small and medium-sized companies. Additionally, the uncertainty surrounding evolving environmental regulations poses considerable legal and financial risks (Y. Wu & Tham, 2023).

Studies show mixed results regarding the impact of environmental factors on financial performance. For instance, Agliardi et al. (2023) found that environmental practices can negatively affect profitability. However, Rahman et al. (2023) demonstrated that such practices can enhance financial performance. Generally, while eco-friendly initiatives may reduce short-term profitability, they have the potential to increase a company's long-term value.

H1: Environmental pillar has a negative effect on financial performance

Social Pillar and Financial Performance

Instead of focusing solely on increasing shareholder value, businesses should consider the interests of all stakeholders, including communities, suppliers, employees, and shareholders, as emphasized by Stakeholder Theory (Freeman, 2010). This theory argues that businesses thrive when they create value for a broader group of stakeholders, ultimately leading to long-term success and sustainable performance.

In the context of ESG, the social pillar involves initiatives such as improving labor conditions, supporting community development, and engaging in ethical business practices (Martiny et al., 2024). These efforts often result in higher operating expenses but can enhance a company's brand reputation and foster stakeholder loyalty. According to Stakeholder Theory, the costs incurred to satisfy stakeholders and maintain strong relationships may not yield immediate financial returns. Consequently, a company's short-term financial performance may be negatively impacted, even though stakeholder goodwill can drive long-term profitability (Maqbool & Zameer, 2018).

To adhere to the social component of ESG, businesses must address the social impact of their operations and prioritize relationships with stakeholders, including employees, clients, and the community. Implementing socially responsible practices can improve a company's reputation and attract sustainability-oriented investors. However, the increased operational costs associated with such programs can reduce profitability in the short term.

Research on the relationship between social factors and financial performance offers mixed results. For example, Bătae et al. (2020) found that social factors negatively impact financial performance, while Tarmuji et al. (2016) provided evidence of a positive correlation. This highlights the complex connection between social and financial performance, suggesting that the benefits of strong social performance are often indirect and require time to materialize.

Ultimately, the influence of social initiatives on financial outcomes depends on the company's ability to leverage these efforts for long-term gains.

H2: Social pillar has a negative effect on financial performance

Governance Pillar and Financial Performance

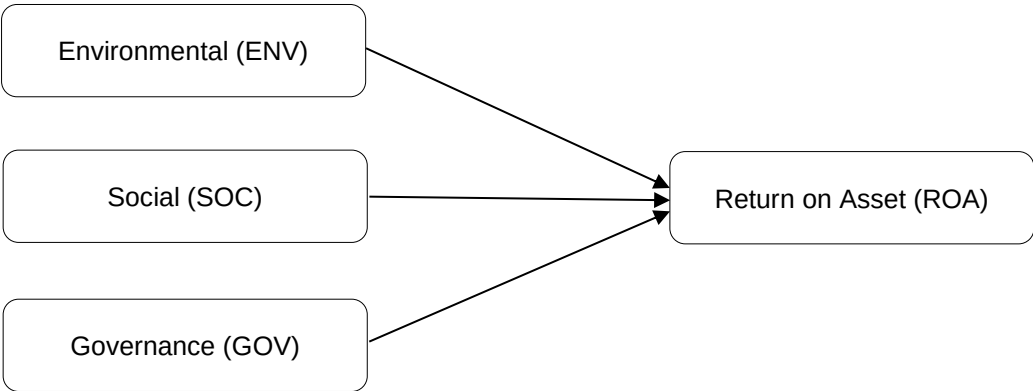
According to Compliance Theory, adhering to governance norms is essential for maintaining organizational legitimacy and ensuring long-term viability (Milgram, 1963). Strong governance principles, such as transparency, accountability, and regulatory compliance, can significantly enhance financial performance, particularly Return on Assets (ROA).

First, effective governance aligns management decisions with shareholder interests, reducing agency risk, improving resource allocation, and ultimately leading to higher returns (Arslan & Alqatan, 2020). Second, compliance with governance standards fosters transparency and trust, which attract investors and lower the cost of capital, thereby boosting profitability. Finally, robust governance mechanisms enhance operational stability by mitigating legal and regulatory risks, ensuring consistent financial performance over time.

These positive impacts highlight that investing in governance practices not only strengthens an organization's credibility and sustainability but also directly contributes to improved ROA through enhanced operational efficiency and financial stability. Supporting this, Fatemi et al. (2018) found a positive relationship between governance pillars and financial performance.

H3: Governance pillar has a positive effect on financial performance

Figure 1. Research Framework



Source: Authors' compilation (2024)

RESULT AND DISCUSSION

Descriptive Statistics

Table 3 shows that the average score for the Environmental variable is 54.13, with a standard deviation of 23.43, indicating a substantial spread in the data. The lowest recorded value for this variable is 5.08, attributed to Security Bank Corp. in the Philippines, while the highest value is 94.85, achieved by DBS Group Holdings in Singapore.

For the Social variable, the average score is 72.576, with a standard deviation of 16.50, reflecting a wide distribution. The lowest value, 21.21, is associated with Hong Leong Bank BHD in Malaysia, whereas the highest value, 93.89, corresponds to Bank Central Asia (BCA) in Indonesia.

Table 3. Desscriptive Statistics

	ENV	SOC	GOV	ROA
Mean	54.136	72.676	64.576	0.012
Median	56.309	77.821	66.378	0.010
Maximum	94.845	93.897	95.663	0.036
Minimum	5.0808	21.210	18.518	0.002
Std. Dev.	23.434	16.505	18.136	0.007
Skewness	0.3772	1.1196	0.4082	0.374
Kurtosis	2.4010	3.6942	2.2519	7.376
Jarque-B	4.8328	28.626	6.3875	102.6
Probability	0.0892	0.0000	0.0410	0.000
Sum	6767.0	9084.6	8072.1	1.553
Sum Sq. Dev.	68100.	33781.	40786.	0.0068
Observation	125	125	125	125

Source: Processed data (2024)

The average score for the Governance variable is 64.576, with a standard deviation of 18.13, indicating a broad distribution of the data. The minimum value for the Governance variable is 18.51, held by Krung Thai Bank PCL in Thailand, while the maximum value is 95.66, owned by Hong Leong Bank BHD in Malaysia.

Lastly, Return on Assets (ROA) variable has an average value of 0.012 and a standard deviation of 0.007, suggesting a relatively narrow data distribution. The lowest ROA value, 0.00226, belongs to CIMB Group Holdings in Malaysia. In contrast, the highest ROA value of 0.036 is recorded by Bank Central Asia (BCA) in Indonesia.

Chow Test

The Chow Test is used to determine whether a Fixed Effects Model (FEM) or a Common Effects Model (CEM) is more appropriate for the data, helping to identify the most suitable model for panel data analysis.

Table 4. Chow test

Effects Test	Statistic	d.f.	Prob.
Cross-section F	1.53268	(16,79)	0.2943
Cross-section Chi-square	26.428468	16	0.07952

Source: Processed data (2024)

The values for Chi-square and Cross-Section F are 0.2943 and 0.07952, respectively, as shown in Table 4. Since both the Cross-Section F and Chi-square probability values exceed the significance level of 0.05, this indicates that the research model used in this experiment is a Common Effects Model (CEM).

Hausman Test

The Hausman Test is used to determine the most appropriate model for panel data analysis, specifically evaluating whether the data is better suited for a Random Effects Model (REM) or a Fixed Effects Model (FEM).

Table 5. Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	3.257322	3	0.3536

Source: Processed data (2024)

The Random Effects Model was chosen for this test because, as shown in Table 4, the random cross-section probability of 0.3536 exceeds the research significance value of 0.05. Based on the results of the two panel data regression model selection tests, a Random Effects Model is used in this study.

LM Test

The LM Test is used to determine the most appropriate model for panel data analysis, specifically evaluating whether a Random Effects Model (REM) or a Common Effects Model (CEM) is more suitable for the data.

Table 6. LM Test

	Cross-section	Time	Both
Breusch-Pagan	0.6832	0.18932	0.586324
	(0.5291)	(0.7427)	(0.5980)

Source: Processed data (2024)

Based on the data presented in the table, the Breusch-Pagan probability (BP) result is 0.52, which is greater than 0.05. Therefore, the most appropriate model to implement is the Common Effects Model.

Panel Data Regression Analysis

To evaluate the hypotheses formulated in this study, panel data regression analysis was conducted using the Common Effects Model (CEM), as indicated by the model selection tests. The CEM was chosen for its suitability to the data structure and its ability to provide consistent estimates of the relationships between the variables.

Table 7. Regression Result

Variables	Coefficient	Std. Error	t-Statistic	Prob.
C	0.001268	0.003827	0.331381	0.7409
ENV	1.80E-05	3.03E-05	0.593786	0.5538
SOC	5.71E-05	4.25E-05	1.344315	0.1814
GOV	9.34E-05	3.66E-05	2.550182	0.0120

Source: Processed data (2024)

From the regression analysis in Table 7, the equation is as follows:

$$ROA = 0.001268 + 1.80E-05 * ENV + 5.71E-05 * SOC + 9.34E-05 * GOV$$

The constant (intercept) is 0.001268, meaning that if the ENV, SOC, and GOV variables are all zero, the ROA will be 0.001268. The ENV coefficient is 1.80E-05, indicating that a 1-point increase in the ENV variable results in a 1.80E-05 increase in ROA. Similarly, the SOC coefficient is 5.71E-05, meaning a 1-point increase in the SOC variable will cause ROA to increase by 5.71E-05. Lastly, with a GOV coefficient of 9.34E-05, a 1-point increase in the GOV variable will lead to a 9.34E-05 increase in ROA.

Discussion

The Influence of Environmental Pillar (ENV) on Return on Asset (ROA)

The analysis revealed that the ENV variable obtained a t-value of 0.5937, with a corresponding t-table value of 1.657 and a probability of 0.55, which is greater than 0.05. This suggests that the results are not statistically significant. The company's financial performance is not significantly affected by the ENV variable, as indicated by the positive t-value. Thus, the study's findings show that environmental performance has relatively little impact on the company's financial success, consistent with previous studies by Lee & Isa (2023). Similarly, the research by Buallay (2020) aligns with these results, suggesting that the banking sector still lacks sufficient regulations addressing social and environmental impacts. Buallay's study further supports these findings, emphasizing the challenges the banking sector faces in incorporating sustainable business practices.

The relationship between environmental performance (ENV) and ROA is complex and influenced by various factors, as proposed by Stakeholder Theory. This theory suggests that companies focused on stakeholder interests, including environmental concerns, may struggle to achieve long-term benefits due to competitive pressures and insufficient incentives for sustainable practices (Talan et al., 2024). Additionally, Agency Theory supports this dynamic, highlighting that managers may prioritize short-term financial goals over long-term environmental investments, particularly when these investments do not yield immediate financial returns (Rivera et al., 2023). As a result, misalignment between management and shareholders' interests may explain the insignificance of environmental performance on financial outcomes, as observed in this study.

Furthermore, in light of the study's conclusions, the environmental (ENV) pillar has no impact on ROA. This could be attributed to minimal or nonexistent investments made in strengthening the environmental pillar during the chosen time period. Notably, the study period coincides with the COVID-19 pandemic, which likely led to a shift in business priorities. Initial investments intended for environmental initiatives were instead redirected to support corporate recovery efforts.

The Influence of Social Pillar (SOC) on Return on Asset (ROA)

Based on the analysis, the SOC variable has a probability of 0.181, which is greater than 0.05, confirming that the SOC variable does not significantly affect the company's financial performance. This aligns with Stakeholder Theory, which suggests that while companies may prioritize stakeholder interests, including social aspects, the long-term benefits are often complex and context dependent. The negative t-value and insignificant results indicate that social performance disclosure does not directly impact financial performance, consistent with findings from Beretta et al. (2024) and Puteri et al. (2018).

Additionally, Agency Theory supports this by suggesting that managers may prioritize short-term financial outcomes and may not perceive immediate financial returns from investing in social initiatives. This results in a misalignment of interests between management and shareholders. As a result, the complexities of the banking industry, competitive pressures, and the lack of strong incentives for social investments may contribute to the insignificant impact of social performance on financial results. This is also noted by Buallay (2020), who highlights the challenges the banking sector faces in integrating social impact regulations.

Moreover, social investments typically yield intangible benefits, such as improved reputation or increased stakeholder trust, which may not always translate into measurable financial gains. During the observed period, especially in the aftermath of the COVID-19 crisis, banks likely shifted their focus toward adapting to digital transformation and addressing credit risk management, leaving limited room for substantial social investments. This shift in priorities could explain the insignificant impact of the SOC variable on financial performance.

The Influence of Governance Pillar (GOV) on Return on Asset (ROA)

GOV obtained a t-value of 2.550182, a t-table value of 1.657, and a probability of 0.012, which is less than 0.05. These results indicate statistical significance and suggest that the GOV variable has a positive impact on financial performance. This study shows that a company's financial performance (ROA) is significantly positively impacted by corporate governance, a finding consistent with those of Gangi et al. (2019). Additionally, Shakil et al. (2019) found a favorable relationship between company performance and governance performance.

Compliance Theory posits that adherence to legal and regulatory standards helps companies reduce risks, maintain legitimacy, and enhance their reputation, which ultimately leads to better financial outcomes (Nakpodia et al., 2023). Similarly, Stakeholder Theory emphasizes the importance of balancing the interests of all stakeholders, which fosters trust, improves decision-making, and drives long-term value creation. Together, these theories explain how effective corporate governance not only ensures regulatory compliance but also strengthens relationships that contribute to enhanced financial performance (Sancha et al., 2023).

Furthermore, the implementation of Good Corporate Governance (GCG) is a key factor in the positive influence of the governance pillar on Return on Assets (ROA). Several banks in this study are recognized as pioneers in GCG implementation. As a result, their business performance is likely directly impacted by these governance practices. The positive impact of the governance pillar in this study suggests that GCG can be practically applied to improve business success, as evidenced by ROA. By enhancing operational efficiency, accountability, and transparency through effective GCG, these institutions can drive improved financial performance and long-term value creation.

CONCLUSION

The purpose of this study is to examine how the environmental, social, and governance (ESG) pillars affect financial outcomes, particularly return on assets (ROA), and how these factors influence the financial performance of banking companies in the ASEAN-5. The findings suggest that corporate governance (GOV) significantly improves ROA, while the environmental and social pillars of ESG do not have a significant impact on financial performance. This highlights the critical role of strong governance policies in enhancing financial success.

The findings have important practical implications. Investors should prioritize corporate governance when evaluating a company's potential for financial success, as it has a more immediate and direct impact on performance compared to the social and environmental pillars. Regulators may want to revise ESG policies to focus more on strengthening governance frameworks and providing incentives for companies that demonstrate robust governance practices. For companies, this study underscores the importance of continuing to invest in improving governance standards, as this can lead to better financial outcomes and long-term sustainability, even if social and environmental initiatives do not yield immediate financial benefits.

Future research could further explore the mechanisms through which corporate governance influences financial performance, particularly in the banking sector. Additionally, future studies could examine the long-term effects of social and environmental factors on financial performance, using more comprehensive ESG metrics to capture the nuanced impact of these factors.

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