

THE INFLUENCE OF ENVIRONMENTAL PERFORMANCE, SOCIAL PERFORMANCE, AND GOVERNANCE PERFORMANCE ON THE FINANCIAL PERFORMANCE OF BANKING COMPANIES LISTED ON THE INDONESIA STOCK EXCHANGE

Dewi Anggraini¹, Ridwan Nurazi², Fitri Santi³, Berto Usman⁴

University of Bengkulu/Management, Indonesia

University of Bengkulu/Management, Indonesia

University of Bengkulu/Management, Indonesia

University of Bengkulu/Management, Indonesia

E-mail: dewa_anggraini@univbinainsan.ac.id¹, ridwan.nurazi@unib.ac.id², fitri_santi@unib.ac.id³, berto_usman@unib.ac.id⁴

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Abstract

This study aims to analyze the influence of environmental performance, social performance, and governance performance on the financial performance of banking companies listed on the Indonesia Stock Exchange for the period 2013–2022. This study uses a quantitative approach with secondary data obtained from company annual reports, financial reports, and the Thomson Reuters Refinitiv Asset4 database. The research sample was determined using a purposive sampling technique, while data analysis was carried out using a panel data regression method using the EViews 10 application. The results showed that environmental performance did not have a significant effect on financial performance as proxied by financial performance with the *Return on Assets* (ROA) approach with a probability value of 0.2978. Social performance also did not have a significant effect on financial performance with a probability value of 0.8998. Similarly, governance performance did not have a significant effect on financial performance with a probability value of 0.4320. These findings indicate that the implementation of environmental, social, and governance aspects in banking companies has not been able to directly increase profitability during the study period. The benefits of implementing these three aspects tend to be long-term, through improved corporate reputation, stakeholder trust, and enhanced business sustainability. Therefore, they are not yet fully reflected in improved financial performance. This research implies that banking companies need to continue strengthening the implementation of sustainability practices as a long-term strategy, while investors need to consider ESG aspects in addition to profitability indicators when evaluating company performance.

Keywords: Environmental Performance, Social Performance, Corporate Governance, Financial Performance, Banking.

INTRODUCTION

Banking is a strategic sector that plays a crucial role in maintaining financial system stability while supporting national economic growth. As an intermediary institution, the banking industry is not only required to deliver optimal financial performance but is also expected to implement sustainable business practices. The shifting global business paradigm demonstrates that a company's success is no longer measured solely by profitability, but also by its ability to manage environmental, social, and corporate governance (ESG) responsibilities. ESG implementation is seen as a strategy for creating long-term value, increasing investor confidence, strengthening a company's reputation, and minimizing various business risks.

The increasing attention to ESG practices is in line with the development of the concept of sustainable development, which encourages companies to integrate economic, social, and environmental aspects into all their operational activities. In Indonesia, the implementation of sustainable finance is increasingly strengthened through various regulations, one of which is the Financial Services Authority Regulation (POJK) Number

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51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies. This regulation encourages companies, particularly in the banking sector, to increase transparency by preparing sustainability reports as a form of accountability to stakeholders.

Theoretically, the relationship between ESG implementation and financial performance can be explained through *Stakeholder Theory* proposed by Freeman (1984). This theory states that companies have responsibilities not only to shareholders but also to all stakeholders, such as employees, customers, government, communities, and the environment. The better a company fulfills its stakeholders' interests through managing environmental, social, and governance aspects, the higher the level of trust it will gain. This trust will strengthen the company's reputation, increase stakeholder loyalty, reduce operational risk, and ultimately have a positive impact on improving the company's financial performance.

Furthermore, this research is also supported by *Signaling Theory* introduced by Spence (1973) and developed in the context of corporate reporting by Connelly et al. (2011). This theory explains that information published by a company serves as a signal for investors in assessing the company's prospects. Disclosure of information regarding environmental, social, and governance performance is a positive signal indicating that the company is professionally managed, committed to sustainability, and capable of managing long-term risks. This positive signal is expected to increase investor confidence, attract investment, strengthen company value, and ultimately improve financial performance. Environmental performance reflects a company's ability to manage its operational impacts on the environment through efficient use of resources, emission reduction, waste management, and the implementation of environmentally friendly policies. Companies with good environmental performance tend to gain higher social legitimacy, reduce legal and operational risks, and improve cost efficiency, thus potentially increasing company profitability.

Social performance reflects a company's commitment to fulfilling its responsibilities to employees, customers, the community, and various other stakeholders. Consistently implemented social responsibility programs can enhance a company's image, strengthen relationships with the community, increase customer loyalty, and create a sustainable competitive advantage. Meanwhile, corporate governance performance demonstrates the effectiveness of the company's management system through the application of the principles of transparency, accountability, responsibility, independence, and fairness. Good corporate governance will reduce agency conflicts, increase the effectiveness of decision-making, and strengthen management oversight, thereby improving the company's operational efficiency and financial performance.

However, previous research on the influence of each ESG dimension on financial performance remains inconsistent. A meta-analysis by Friede, Busch, and Bassen (2015) found that most studies demonstrated a positive relationship between ESG practices and corporate financial performance. Similarly, Velte's (2017) study showed that ESG implementation generally had a positive impact on corporate profitability. Conversely, Atan et al. (2018) found that not all ESG dimensions significantly impact financial performance, suggesting that the effectiveness of each dimension depends on industry characteristics and company conditions. Another study by Buallay (2019) also showed that the influence of environmental, social, and governance aspects on financial performance varies across industry sectors.

The differences in these research results indicate a persistent *research gap* regarding the relationship between environmental performance, social performance, and governance performance on financial performance, particularly in the Indonesian banking industry. In addition to having distinct characteristics compared to other sectors, the banking industry also faces increasing demands in implementing sustainable finance principles. Therefore, this study focuses on analyzing the influence of environmental performance, social performance, and governance performance on the financial performance of banking companies listed on the Indonesia Stock Exchange, using *Return on Assets (ROA)* as a proxy for financial performance. The research findings are expected to provide an empirical contribution to the development of ESG literature and serve as a consideration for company management, investors, and regulators in improving the implementation of sustainability practices in the banking sector.

LITERATURE REVIEW

Stakeholder Theory

Stakeholder Theory was introduced by Freeman (1984), which states that companies are not only responsible to shareholders but also to all stakeholders, such as employees, customers, creditors, the government, the community, and the environment. A company's long-term success is greatly influenced by its ability to meet the expectations of these various groups. Therefore, companies need to create sustainable value through good

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relationship management with all stakeholders. In the context of this research, the implementation of environmental, social, and corporate governance practices represents a form of corporate responsibility to stakeholders. Banking companies that maintain environmental quality, prioritize social welfare, and implement good governance will gain legitimacy, enhance their reputation, and strengthen investor and public trust. This is ultimately expected to improve the company's financial performance.

Signaling Theory

Signaling theory was proposed by Spence (1973) to explain how a party with more information sends signals to other parties to reduce information asymmetry. In the corporate context, disclosing information on environmental, social, and governance performance is a positive signal, indicating that the company has good management quality, is able to manage risks, and is oriented towards sustainability. This information serves as a basis for investors in assessing the company's prospects and making investment decisions.

The higher the quality of ESG disclosure, the greater investor confidence in a company's prospects. This trust can increase investment attractiveness, strengthen a company's reputation, and drive long-term financial performance.

Environmental Performance

Environmental performance is a company's ability to manage the impact of its operational activities on the environment through energy efficiency, waste management, emissions reduction, natural resource conservation, and the implementation of environmentally friendly policies. In ESG research, the environmental dimension is generally measured using the *Environmental Score* published by *Refinitiv Asset4*.

According to *Stakeholder Theory*, companies with good environmental performance will receive greater support from the public, regulators, and investors. Furthermore, effective environmental practices can reduce operational risks and improve cost efficiency, potentially increasing company profitability.

Social Performance

Social performance demonstrates a company's ability to fulfill its responsibilities to stakeholders through employee rights protection, human resource development, workplace safety, customer satisfaction, diversity, inclusion, and community contributions. This study used the *Refinitiv Asset Social Score4* to measure social performance.

Based on *Stakeholder Theory*, companies that maintain good relationships with their stakeholders will experience customer loyalty, higher employee productivity, and a better corporate image. These conditions can provide a competitive advantage that supports improved financial performance.

Governance Performance

Governance performance reflects the effectiveness of a company's management system through the application of the principles of transparency, accountability, responsibility, independence, and fairness. Good corporate governance can minimize agency conflicts, increase oversight effectiveness, and strengthen decision-making quality. In this study, governance performance was measured using the *Governance Score* from *Refinitiv Asset4*.

According to *Signaling Theory*, companies with good governance send a signal to investors that the company is professionally managed, transparent, and carries lower risks. This signal can increase investor confidence and positively impact the company's financial performance.

Financial performance

Financial performance is an indicator that demonstrates a company's ability to generate profits through the utilization of its resources. This study uses *Return on Assets* (ROA) as a proxy for financial performance because this ratio reflects a company's effectiveness in generating profits from all its assets.

ROA is calculated using the formula:

$$\text{ROA} = \text{Net Profit After Tax} / \text{Total Assets} \times 100\%$$

The higher the ROA value, the more efficient the company is in managing assets to generate profits, thus reflecting better financial performance.

Hypothesis Development

The Influence of Environmental Performance on Financial Performance

Environmental performance reflects a company's ability to manage the impact of its operational activities on the environment through efficient energy use, waste management, emission reduction, and compliance with environmental regulations. According to *Stakeholder Theory* (Freeman, 1984), companies that meet stakeholder expectations, including those related to the environment, will gain legitimacy, enhance their reputation, and strengthen relationships with investors and the community. This can enhance competitive advantage and impact financial performance.

Furthermore, *Signaling Theory* explains that disclosing information on environmental performance is a positive signal to investors regarding a company's commitment to sustainability and its ability to manage long-term risks. This signal can increase investor confidence and support increased company profitability.

Research by Friede, Busch, and Bassen (2015) shows that ESG practices have a positive relationship with corporate financial performance. Bătae et al. (2021) also found that the environmental dimension positively influences banking sector profitability. These research results indicate that companies with good environmental performance tend to improve operational efficiency and gain greater stakeholder trust.

Based on this description, the first hypothesis in this study is formulated as follows.

H1: Environmental performance has a positive effect on the financial performance of banking companies.

The Influence of Social Performance on Financial Performance

Social performance demonstrates a company's commitment to fulfilling its responsibilities to employees, customers, the community, and other stakeholders. According to Stakeholder Theory, companies that consider the interests of stakeholders will gain customer loyalty, increase employee productivity, and build a better corporate reputation. This can enhance a company's competitiveness and drive improved financial performance.

From a *Signaling Theory perspective*, disclosure of corporate social activities signals a company's strong social responsibility and sustainability orientation. This information can increase investor confidence in the company's future prospects.

Velte's (2017) research shows that ESG implementation contributes to increased corporate profitability. However, Atan et al. (2018) found that the influence of social dimensions on financial performance is not always significant, so empirical testing is still needed in various industrial sectors, including the banking sector in Indonesia.

Based on this description, the second hypothesis is formulated as follows.

H2: Social performance has a positive effect on the financial performance of banking companies.

The Influence of Governance Performance on Financial Performance

Corporate governance performance *reflects* the effectiveness of the application of the principles of transparency, accountability, responsibility, independence, and fairness in company management. Good governance can reduce agency conflicts, improve the quality of oversight, strengthen internal control systems, and increase the efficiency of decision-making.

According to *Signaling Theory*, companies with good governance send positive signals to investors regarding the quality of management and low risk. Meanwhile, *Stakeholder Theory* explains that effective governance will increase stakeholder trust, thereby supporting the company's sustainability.

Research by Buallay (2019) shows that corporate governance plays a crucial role in improving company performance, although the extent of the impact varies across industries. Menicucci and Paolucci (2023) also found that implementing good governance can improve the stability and profitability of the banking sector through more effective risk management.

Based on the theory and results of previous research, the third hypothesis is formulated as follows.

H3: Governance performance has a positive effect on the financial performance of banking companies.

Framework of Thought

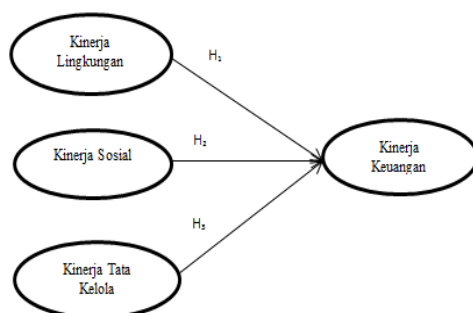


Figure 1. Framework of Thought

The analytical framework of this study shows that environmental performance, social performance, and governance performance are suspected to influence the financial performance of banking companies as proxied by *Return on Assets* (ROA). This relationship is based on *Stakeholder Theory* and *Signaling Theory*, which explain that the implementation of good ESG practices can increase stakeholder and investor trust, thereby impacting the company's financial performance.

METHOD

This research design is a quantitative research design that uses an approach that generates numerical data and then analyzes it statistically. It involves collecting data from a population or sample that represents a specific population. The primary goal of this research is to describe the phenomenon being studied and test pre-established hypotheses.

The population in this study was all banking companies listed on the Indonesia Stock Exchange (IDX) during the period 2013–2022. The banking sector was chosen because of its strategic role in the national financial system and its initiation of implementing *Environmental, Social, and Governance* (ESG) practices as part of sustainable finance. Furthermore, banking companies are one of the sectors that consistently publish annual reports and sustainability reports, enabling the collection of the data needed for this study.

The research sample consists of banking companies that meet the research criteria during the 2013–2022 period. The sample was determined by considering the availability of *Environmental Score*, *Social Score*, *Governance Score* data, and data *Return on Assets* (ROA). The research data were obtained from annual reports, company financial reports, the official website of the Indonesia Stock Exchange (www.idx.co.id), the official websites of each company, and the *Refinitiv Asset4* database from Thomson Reuters.

The sampling technique used in this study was *purposive sampling*, which is a technique for determining samples based on specific criteria tailored to the research objectives. The sample criteria used are as follows:

1. Banking companies listed on the Indonesia Stock Exchange during the period 2013–2022.
2. Published annual reports and financial statements consecutively during the study period.
3. *Environmental Score*, *Social Score*, and *Governance Score* data available on Thomson Reuters' Refinitiv Asset4 database.
4. complete *Return on Assets* (ROA) data during the research period.
5. No *delisting* occurred during the observation period.

Companies that meet all these criteria are designated as research samples and are then analyzed using panel data for the period 2013–2022.

This study uses secondary data obtained from annual reports and financial statements of banking companies listed on the Indonesia Stock Exchange (IDX) for the period 2013–2022. Annual report and financial statement data were obtained from the official website of the Indonesia Stock Exchange (www.idx.co.id) and the official websites of each company.

performance, social performance, and governance performance data were obtained from Thomson Reuters' Refinitiv Asset4 database, which provides ESG scores on a scale of 0–100. Meanwhile, financial

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performance data was obtained from the company's annual financial report and measured using *Return on Assets* (ROA).

Data analysis in this study was conducted using the *EViews* 10 application. Because the data used is a combination of *cross-sectional* (company) and *time series data* (2013–2022), the analytical method used is panel data regression.

The stages of data analysis include:

1. Descriptive Statistical Analysis

Descriptive statistics are used to provide an overview of the characteristics of each research variable through minimum, maximum, average (*mean*) and standard deviation values.

2. Selection of Panel Data Regression Model

To obtain the most appropriate estimation model, several tests were carried out as follows:

- *Chow test*, to determine the *Common Effect* or *Fixed Effect model*.
- *Hausman test*, to determine the *Fixed Effect model* or *Random Effect*.
- *Lagrange Multiplier* (LM) test, to determine the *Common Effect* or *Random Effect model*.

The selected model will be used as a basis for hypothesis testing.

3. Classical Assumption Test

Classical assumption tests are performed to ensure that the regression model meets the statistical assumptions. The tests include:

- Normality Test
- Multicollinearity Test
- Heteroscedasticity Test
- Autocorrelation Test

4. Panel Data Regression Analysis

Hypothesis testing was conducted using panel data regression analysis to determine the effect of environmental performance, social performance, and governance performance on the financial performance of banking companies.

The regression model used is:

$$ROA = \alpha + \beta_1 ENV + \beta_2 SOC + \beta_3 GOV + \epsilon$$

Information:

ROA = Financial Performance

α = Constant

β_1 – β_3 = Regression coefficient

ENV = Environmental Performance

SOC = Social Performance

GOV = Governance Performance

e = *Error term*

5. Goodness of Fit Test

The feasibility of the model is analyzed through:

- Coefficient of Determination (R^2), to measure the ability of independent variables to explain variations in financial performance.
- F test, to determine the influence of independent variables simultaneously on financial performance.
- T-test, to determine the influence of each independent variable on financial performance partially.

Hypothesis testing criteria use a significance level of 5% ($\alpha = 0.05$). The hypothesis is accepted if the probability value (p-value) < 0.05 , and rejected if the p-value is > 0.05 .

RESULTS AND DISCUSSION

The Influence of Environmental Performance on Financial Performance

These results indicate that environmental performance has not been able to provide a direct impact on the efficiency of asset use in generating profits during the research period. In accordance with the results of the partial hypothesis test, it shows that the Environmental Performance variable obtained a t-count value of 1.045851 which is smaller than the t-table, namely (1.045851 $>$ 1.98304) and a probability value of 0.2978 $<$ 0.05. Thus, H_0 is

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accepted and H1 is rejected, so that It can be concluded that the environmental performance variable (*Environmental* /Score E) does not affect financial performance, in this case ROA. This means that high or low environmental performance does not affect financial performance (ROA). Environmental investments in the banking sector are generally long-term and require relatively high costs, while the economic benefits, such as improved reputation, public trust, and customer loyalty, are only felt in the long term. Therefore, the impact of environmental performance on accounting-based profitability is not yet directly visible.

The findings of this study align with those of Qiu et al. (2016), Nollet et al. (2015), and Ruan and Lin (2021), who stated that environmental performance had no significant effect on ROA. However , these results differ from those of Wang and Sarkis (2017), Volte and Stawinoga (2017), and Kim and Li (2021), who found that environmental performance had a positive effect on profitability. These differences indicate that the influence of environmental performance on financial performance is highly dependent on industry characteristics, the study period, and the time horizon for performance measurement.

The Influence of Social Performance on Financial Performance

The results of the partial hypothesis test show that social performance (X2) does not have a significant effect on financial performance (ROA) . **The calculated t - value of -0.126187 is smaller than the t -table. (1.98304)** with a significance level of $0.8998 > 0.05$, so H2 is rejected and H0 is accepted . **This finding indicates that high or low corporate social performance does not have a direct impact on increasing profitability as measured using ROA.**

These results indicate that the social activities of banking companies have not been able to provide a direct impact on financial performance in the short term . Based on *Stakeholder Theory* and *Legitimacy Theory* , social performance plays a greater role in building reputation, legitimacy, and long-term relationships with stakeholders, rather than generating direct financial benefits. The economic impact of social performance is generally indirect and can only be felt in the long term, for example through increased trust, customer loyalty, and corporate image.

The findings of this study align with those of Vasconcelos et al. (2022), Ruan and Lin (2021), and Nollet et al. (2015) , who stated that social performance had no significant effect on ROA. However, these results differ from those of Kim and Li (2021), Wang and Sarkis (2017), Velte and Stawinoga (2017), and Qiu et al. (2016) , who found that social performance had a positive effect on profitability. These differences in findings indicate that the influence of social performance on ROA is highly dependent on the industry context, observation period, and financial performance measurement mechanism used .

Disclosure of Governance on Financial Performance

The results of the partial hypothesis test indicate that governance disclosure (X3) does not have a significant effect on financial performance (ROA) . **The calculated t - value of 0.795853 is smaller than the t -table (1.98304)** with a significance level of $0.4320 > 0.05$, so H3 is rejected . This finding indicates that the high or low level of corporate governance disclosure has not been able to provide a direct impact on profitability as measured by ROA.

Theoretically, *Agency Theory* states that good corporate governance practices aim to minimize conflicts of interest between management (agents) and shareholders (principals) by increasing transparency, accountability, and oversight mechanisms. Effective governance practices are expected to improve operational efficiency and financial performance. However, the results of this study indicate that the governance mechanisms disclosed by banking companies have not directly contributed to increased asset profitability . This indicates that the benefits of governance are more long-term or indirect, for example through strengthening investor confidence and operational stability, rather than increasing profits in the short term.

The results of this study are not in line with Kim and Li (2021) and Velte and Stawinoga (2017). who found that governance disclosure had a positive effect on ROA. However, this finding is consistent with Ruan and Liu (2021), Wang and Sarkis (2017), and Nollet et al. (2015), who stated that governance disclosure had no significant effect on company profitability. These differences in results indicate that the effectiveness of governance in improving financial performance is significantly influenced by industry characteristics, the quality of GCG implementation, and the time horizon of performance measurement.

CONCLUSION

Conclusion

Based on the results of the data analysis in the discussion previously outlined regarding the role of CSR Awards in strengthening the influence of ESG on financial performance and company value in banking companies listed on the Indonesia Stock Exchange (IDX), the following conclusions were obtained:

- a. The t-test results for the environmental performance variable indicate that it has no effect on financial performance, specifically ROA. This means that high or low environmental performance does not affect financial performance (ROA).
- b. The results of the t-test on social performance show that the social performance variable does not have a significant effect on ROA, which means that the high or low social performance of a company does not will increase the company's profitability (ROA).
- c. The t-test results on the governance disclosure variable indicate that the governance disclosure variable has no significant effect on ROA. This means that companies with high or low governance disclosure will not affect the company's financial performance, in this case ROA.

Suggestion

Based on the results of research on the influence of environmental performance, social performance, and governance performance on the financial performance of banking companies listed on the Indonesia Stock Exchange, the following suggestions can be given.

1. For Companies

Banking companies are expected to continue improving the implementation of sustainability practices, particularly in environmental, social, and corporate governance aspects. Improving the quality of environmental management, awareness of social responsibility, and the implementation of good corporate governance are expected to increase stakeholder trust, strengthen the company's reputation, and support improved financial performance. Furthermore, companies need to improve the quality of transparent and consistent disclosure of sustainability information as a form of accountability to investors, regulators, and the public.

2. For Investors

Investors are advised to consider information on environmental, social, and governance performance as a basis for making investment decisions. ESG assessments not only reflect a company's commitment to sustainability but can also be an indicator of its ability to create long-term value and manage business risks.

3. For Further Researchers

Future researchers are advised to expand the scope of the study by extending the observation period, using samples from other industrial sectors, or conducting comparative research across countries to obtain more comprehensive results. Furthermore, future research could add other variables that could potentially influence financial performance, such as company size, leverage, profitability, or firm value, and use more complex analytical methods, such as *the Generalized Method of Moments (GMM)*, *Dynamic Panel Data*, or *Structural Equation Modeling (SEM)*, to provide a deeper understanding of the relationship between sustainability practices and company performance.

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