CHAPTER 1 INTRODUCTION

1.1 Overview of Research Object

In general, the conventional banking industry in Indonesia has experienced rapid growth in the past few decades. The term 'big four' banks according to their total assets consists of Bank Mandiri, BRI, BNI, and BCA have expanded their branch networks and provided various types of banking products and services to meet consumer needs. In addition, the conventional banking industry in Indonesia has also undergone digital transformation by launching various digital banking services such as Internet banking, mobile banking, and electronic payments that make it easier for consumers to conduct financial transactions.

According to information provided by the Financial Services Authority Otoritas Jasa Keuangan OJK (2022), conventional banks in Indonesia achieved total asset value of a 7,987 trillion Indonesian Rupiah (IDR) in 2021. On the other hand, they extended a total of 5,709 trillion Indonesian Rupiah (IDR) in credit. Additionally, the conventional banking industry was able to reduce the percentage of non-performing loans, known as the NPL ratio, from 3.67% at the end of 2020 to 3.31% at the end of 2021.

However, as was stated earlier, the conventional financial sector is also confronted with several difficulties, According to a report that was published, in order for banks in Indonesia to be able to sustain their business growth, they need to continue to focus their attention on risk management, innovate digital banking products and services, and maintain customer confidence in a variety of aspects, including ESG (PWC Indonesia, 2021).

The concern for global warming has become a significant factor for many banking companies to take environmental issues more seriously. It is not rare for a company's operations to have adverse effects on the environment.

Deforestation is mostly caused by the conversion of forests into oil palm plantations, moreover, Indonesia contributes 53% of oil palm cultivation in the World (Badan Pusat Statistik, 2019) These high-risk industrial sectors can operate because of funding coming from financial services institutions. So, consequently financial service institutions such as banks also play a role in supporting environmental damage.

According to Scholtens (2008), the sustainability of a company depends on the nature of its engagement with the community and the environment surrounding it. Thus, companies are now placing greater emphasis on their social responsibility to ensure long-term sustainability. In recent years, conventional banks in Indonesia have increasingly recognized the importance of environmental, social, and governance (ESG) considerations in their business operations. According to a report by Bank Indonesia (2020), many conventional banks in Indonesia have established ESG policies and practices and are actively integrating ESG factors into their risk managementframeworks. Furthermore, it is crucial to maintain the balance between the company's economic, environmental, and social aspects.

In 2017, the Financial Services Authority (OJK) acted as a regulator and issued the Financial Services Authority Regulation Number 51/Pojk.03/2017 to implement sustainable finance for financial services institutions, issuers, and public companies. Article 10 of the regulation mandates that Financial Services Institutions, issuers, and public companies must create regular reports, with the obligation to begin continuous reporting starting in 2019.

The focus of this study is to examine the profitability in conventional banking industries that are listed in Indonesia Stock Exchange or IDX. As follows: Table 1.1 will be showing the list of conventional banks that are listed in IDX.

No	Bank Name	Stock Code	IPO date
1.	PT Bank Central Asia Tbk	BBCA	2000-05-31
2.	PT Bank Rakyat Indonesia Tbk	BBRI	2003-11-10
3.	PT Bank Mandiri Tbk	BMRI	2003-7-14
4.	PT Bank Tabungan Negara Tbk	BBTN	2009-12-17
5.	PT Bank Bumi Arta Tbk	BNBA	2006-6-01
6.	PT Bank Mega Tbk	MEGA	2000-04-17
7.	PT Bank OCBC NISP Tbk	NISP	1994-10-20

Table 1.1 List of Conventional Banks Listed in IDX

Source: (IDX, 2020)

According to Table 1.1, there are 7 conventional banks that are listed in IDX including its stock code, the Indonesia Stock Exchange (IDX) assigns a unique four-letter code to each issuer who owns shares and is listed on the exchange. This stock code serves the purpose of facilitating buying and selling transactions of the issuers who use IDX's trading system. This research will examine the conventional bank with a period from 2018 to 2022.

1.2 Research Background

There is an established connection between the banking sector and economic growth. Each affect and affects the other in important ways. There is a strong link between the banking business and the growth of the economy. As the economy grows, banks are able to lend more money to businesses and people and offer more financial services. This helps the economy grow even more. On the other hand, according to (IMF, 2019) a steady economic progress needs a banking system that works well. Banks are very important because they connect savers and borrowers, put money into useful investments, and make it easier for people to buy and sell things. A solid financial system, which includes a strong banking industry, can help the economy grow and improve in significant ways (Levine, 2021).

Companies, as one of the economic actors who frequently cause environmental problems, must contribute to the realization of this sustainable development. Here, the company banking as a business entity that provides a variety of financial requirements in the form of banking services also has a significant social and economic impact (Puspitasari & Septiani, 2017). The company can conduct sustainable development in a transparent and scalable manner with Environmental, Social, and Governance.

The rise in global temperatures over the past 100 years is what encouraged the research and development of the ESG concept.

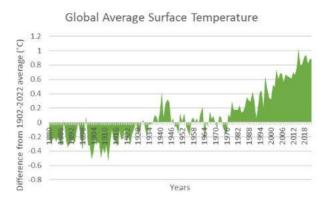


Figure 1.1 Average global temperatures

Source: (NOAA National Centers for Environmental Information, 2022)

The previous 100 years consequently have seen an increase in global temperatures, according to data from the NOAA National Centers for Environmental Information (2022). It can be seen that the increase has continued to this day. In a simple way, ESG disclosure refersto the voluntary publication of information by companies on their environmental, social, and governance practices. This information can help investors and other stakeholders make smart choices about the companies in which they invest or with which they work. Studies have shown that ESG disclosure can positively impact a company's financial success, including profitability.

There has not been a lot of research on how ESG disclosure affects the bottomline in conventional banking industries. Referring to Giri (2017) banks contend with one another to keep their consumers. A few studies, on the other hand, have shown a link between ESG disclosure and profit in conventional banks. Based ona previous study that the writer found in the earlier journal, the writer found that there are both positive and negative impacts of ESG disclosure in

the banking industry. For example, a study by according to Tarmuji et al. (2016), proper management of ESG concerns fosters a business spirit and atmosphere that strengthens both a company's social integrity and stakeholder trust. As a result, organizations that publish ESG policies in mainstream media are said to have improved their reputation, enhancing investor trust, making better use of resources, and remaining competitive. Another study by Feroz and Park (2020) showed that bankswith higher ESG scores have better financial performance and profitability in terms of customer trustworthiness. In addition, a Harvard Business Review study revealed that companies with high ESG ratings have a lower cost of capital and a higher return on equity than those with low ESG ratings (Eccles & Serafeim, 2013). MSCI ESG Research found in a separate study that companies with high ESG ratings have less earnings volatility and are less likely to be involved in significant controversies.

The previous research conducted by Climent (2018) demonstrated the negative impact of ESG on the performance of return on assets and return on equity. Negative outcomes are considered because companies that engage in ethical practices have greater resources to implement social initiatives, to the company's detriment. Studiesfrom Buallay (2019) also demonstrated the same outcomes: However, the corporate governance disclosure was found to negatively affect the ROA, and ROE and positively affect the Tobin's Q.

Based on a report by the Global Sustainable Investment (Global Sustainable Investment Alliance, 2018) ESG integration has become increasingly important for investors and businesses seeking to create long-term value while considering the potential risks and opportunities presented by environmental, social, and governance factors.

The Indonesian government has taken action to support businesses in implementing sustainable reports in response to this situation. The Financial Services Authority has released Financial Services Authority Regulation Number 51/POJK.03/2017 addressing the Implementation of Sustainable Finance for Financial Service Institutions, Issuers, and Public Companies through the OJK. The laws and regulations established by OJK in March 2017 are the reasons why

this research, which was done from 2018 to 2022, appears to be relevant. Therefore, the author believes that the ideal period for doing this research is to begin in 2018, roughly one year after the law has been implemented.

By creating a synergy between economic, social, and environmental factors, sustainable financial reporting aims to ensure economic stability and inclusivity (Husada & Handayani, 2021). Based on a survey from the KPMG CSR Survey (2017), using the Global Reporting Initiative (GRI) reporting framework, since 2008, there has been a 41.5% increase in the disclosure value of sustainable financial reports, from 53% in 2008 to 75% in 2018. This demonstrates that an increasing number of businesses understand their responsibility for protecting social and environmental components in order to sustain public trust.

In this research, the writer will be using green loans as an independent variable. Green loans are a form of financing designed particularly to support environmental and sustainability initiatives. Green loans are a valuable tool for promoting sustainable development, according to Goh et al. (2021) because green loans can help fill the financing gap that frequently exists for green initiatives. The significance of collaboration between financial institutions, governments, and other stakeholders in the development of green loan frameworks and standards that can facilitate the expansion of sustainable financing. In addition to reducing the environmental impact of businesses, green loans can also generate financial benefits, such as reduced energy costs and an enhanced brand reputation.

Furthermore, in relation to green loans, it is important to consider corporate social responsibility (CSR) which will be used as an independent variable in this research. The term "Corporate Social Responsibility fund" refers to the allocation of financial resources by businesses to initiatives that promote social welfare, environmental sustainability, and ethical business practices (Carroll, 2016). Due to the introduction of the Limited Liability Company Law article 74 No. 40/2007, which requires companies operating in the natural resources sectorto allocate a portion of their profits to CSR activities, CSR has gained recognition in Indonesia (Harjoto & Jo, 2011). Additionally, the banking sector has recognized the

importance of CSR in maintaining trust among stakeholders, boosting its image, and encouraging sustainable development (Susanti & Dewi, 2019).

Several banks in Indonesia have actively pursued CSR initiatives with a concentration on education, healthcare, and the environmental (Widyastuti, & Ramdani, 2019). A growing corpus of research indicates a positive relationship between corporate social responsibility (CSR) activities and the financial performance of Indonesian banks, showing that CSR investments can contribute to increased profitability, improved customer satisfaction, and sustainable growth (Arifin et al. 2017). Consequently, the incorporation of CSR funding in the banking industry does not only satisfy social and environmental obligations but also has an opportunity of offering a competitive advantage, that will benefit both the banks and the communities they support.

Based on ESG and CSR banks are also responsible towards their customers as one of their stakeholders. The Indonesia Deposit Insurance Corporation (LPS), also known as Lembaga Penjamin Simpanan (LPS), is responsible for ensuring stability in the banking system and safeguarding depositors' interests (Sahut et al. 2016). Refer to Kusairi et al. (2015) the main motive for instituting deposit insurance is to share risk between banks and insurance providers. Bankruptcy is something that is undesired by all parties. Hence, in the case of an inevitable bank failure in Indonesia, depositors can rely on the protectionprovided by the Deposit Insurance Corporation (LPS), LPS also used by the author in this research as an independent variable. The LPS collects an insurance premium from Indonesian banks equal to a percentage of their total assets. The deposit insurance premium in Indonesia is affected by a number of variables, such as the scale of the bank, its liquidity, and its profitability (Prastiwi & Utami, 2020). The showed that insurance premiums are lower for larger banks that have higher liquidity and profitability and higher for smaller banks that have lower liquidity and profitability. Banks can be incentivized to improve their risk management and financial success through the deposit insurance premium.

The LPS has helped make the Indonesian banking system more stable andresilient by giving investors a safety net and stopping the ripple effect that can happen when a bank fails (Sugiharsono & Hidayat, 2018). The existence of insurance on deposits has also been linked to more financial intermediation. The reason is that depositors are more likely to put their money in banks that offer deposit insurance. This means that banks can give more money and help the economy grow (Kartika & Siregar, 2017). As a result, the Deposit Insurance Corporation is a very important part of building trust and security in the Indonesian banking industry, which plays a part in the country's economy growth.

The existence of a solid and credible LPS can provide financial stability for the banking industry as a whole and encourage the growth of total assets in the sector. Total assets in the Indonesian banking industry predominantly consist of reserves of cash, securities, financing, and other financial instruments (Kuncoro & Suhardjanto, 2017). Managing total assets is crucial for Indonesian banks because it has a direct impact on their profitability, liquidity, and solvency (Munawar, 2017). As banks generate revenue through investments and lending activities, an in-equilibrium asset portfolio is essential for maintaining profitability and mitigating risk. Total assets will be used by the author as a control variable. Total assets use as a control variable in research on Net Interest Margin (NIM) to account for the size-related impact, allowing researchers to isolate and assess the specific influence of other factors on NIM while controlling for variations in bank size.

The correlation across total assets and different elements of the Indonesian banking industry, such as profitability, efficiency, and management of risks, has been assessed by researchers (Puspitasari et al. 2019). In addition to this, the research indicates that a bank's total assets can be used to forecast the risk-taking behavior of the institution as well as its capacity to withstand economic crises. To assess the financial stability, performance, and general contribution of Indonesian banks to the economy, it is crucial to comprehend the composition and administration of their total assets.

In this ongoing research, Return on Assets (ROA) and Net Interest Margin (NIM) will be utilized as dependent variables. ROA is an essential performance indicator in the banking industry because it provides insight into a bank's profitability, risk-taking behavior, and asset management efficacy (Kosmidou, 2008). It is especially important for banks, whose business model heavily depends on asset leverage to generate income (Samad, 2018). In addition, researchers and regulators have utilized ROA to analyze the effects of various factors, including competition, regulation, and macroeconomic conditions, on the performance of banks. According to the results of a study that was recently published (Cho and Kim, 2018), ROA is an important tool for investors because not only it can assist in identifying companies that are performing well, also it may identify the company that has financial difficulties. According to the research, businesses that had a higher ROA tended to have a higher market value, a higher return on equity (ROE), and lower levels of financial distress than businesses that had an ROA that was lower. Based on the findings of the research, ROA has the potential to serve as a useful key performance indicator for businesses operating in a variety of different fields.

In line with the findings of a different piece of research (Rahman and Uddin, 2019), ROA is of the highest importance in the financial sector. According to the findings of the research, financial institutions that have a higher ROA also tend to have lower risk levels and higher levels of efficiency than financial institutions that have a lower ROA. In addition, the research indicates that ROA can be utilized as a tool to evaluate the efficiency of a bank's risk management practices as well as the institution's capacity to generate profits while simultaneously minimizing risk. In general, return on assets (ROA) is a vital indicator that can provide insightful information regarding the financial performance and profitability of a business. By analyzing ROA along with various other financial ratios and indicators, investors and analysts can gain a more comprehensive comprehension of the financial health of a company and make investment decisions that are more in line with their best interests. Thus, the study of ROA in the context of the banking industry provides valuable insights into the efficiency with which banks utilize their assets and the impact that external factors may have on their profitability.

Beside ROA, profitability also can be measure by the Net Interest Margin (NIM) is calculated by comparing net interest income, which is the difference between interest revenue and interest expense, to average earning assets. It is a measure of bank efficacy by itself. The ratio that is crucial to bank management, as well as shareholders in the banking sector, is the net interest margin ratio. The net ratio interest margin can be used as a reference when deciding on a strategy for investors and banking management Setiawan et al. (2019). A bank can achieve its desired level of efficiency by implementing multiple strategies. Maximizing the spread between loan and deposit rates is one of the common strategies. Referring to Setiawan et al. (2019) the term "bank size" refers to the size of a bank defined by its total assets. When banks have huge amount of total assets, it will further boost confidence among depositors and consumer borrowers. The level of customer trust in banks with huge total assets will cause the banks to have less financial problem in the future.

In the Indonesian banking industry, the significance of ESG factors is becoming increasingly apparent. Many banks have begun to integrate ESG factors into their business strategies and operations, recognizing that responsible and sustainable practices can contribute to long-term profitability and growth. In recent years, the banking industry in Indonesia has experienced fluctuations in terms of NIM. According to data from the Financial Services Authority (OJK, 2020), the average NIM for commercial banks in Indonesia was 4.93 percent in 2019.

The Global Sustainable Investment Alliance's (GSIA) 2020 report on sustainable investment globally, including Indonesia, provides insight into the ESG trend in Indonesia. The most recent report published in 2020 revealed that sustainable investment in Indonesia had reached US\$4.7 billion, or about 4% of total investment management assets in Indonesia, which is quite high and is anticipated to continue to rise in the years to come. The trend of ROA, NIM, and NPM in conventional banking industries in Indonesia can be gleaned from the financial statements of banks listed on the Indonesia Stock Exchange or the Financial Services Authority. (OJK, 2021), Bank Mandiri's financial report revealed ROA of 2.44 percent, NIM of 4.10 percent, and NPM of 20.0 percent. In 2021, Bank Central Asia (BCA) reported a ROA of 2.56 percent, a NIM of 6.76 percent, and an NPM of 29.52 percent (Mandiri Financial Report, 2021). Based on the findings of the earlier research that was mentioned above, it is predicted that business actors, particularly in the financial sector, will not only concentrate on aspects related to profits, but will also be able to integrate aspects related to the environment, society, and governance into business processes. These aspects are outlined in the disclosure of sustainability reports, which are intended to implement responsible and sustainable business practices.

Based on the description above, research on the factors that many researchers have done to impact the company's profitability. However, there are still contradictions in the obtained research results. This disparity gives the author cause to reconsider the effect of sound corporate governance disclosure on company profitability. This study employs secondary data, namely financial reports and annual ESG disclosure reports, for the five-year period 2018-2022. Therefore, the title of this study is "THE EFFECT OF ESG DISCLOSURE TOWARDS PROFITABILITY IN **CONVENTIONAL** BANKING INDUSTRIES (LISTED IN IDX 2018-2022) WITH TOTAL ASSETS AS THE CONTROL VARIABLE" with data obtained from each company's website between 2018 and 2022, as it is believed that the data for that period is sufficient to explain the researcher's purpose to determine the effect of good corporate governance disclosure towards profitability on conventional banking.

1.3 Problem Formulation

The banking sector and economic growth have a strong connection, withbanks' lending more money to businesses and people and offering more financial services. Companies must contribute to the realization of sustainable development by conducting environmental, social, and governance (ESG) disclosure in their decision-making processes.

Through the explanations stated at this point, a few questions have been raised that are the ground for this thesis. These are:

- 1) Does the green loans significantly affect on ROA in the conventional banking industry?
- 2) Does CSR funds significantly affect on ROA in the conventional banking industry?
- 3) Does the deposit insurance premium significantly affect on ROA in the conventional banking industry?
- 4) Does total assets significantly affect on ROA in the conventional banking industry?
- 5) Does green loans significantly affect on NIM in the conventional banking industry?
- 6) Does CSR funds significantly affect on NIM in the conventional banking industry?
- 7) Does deposit insurance premium significantly affect on NIM in the conventional banking industry?
- 8) Does total assets significantly affect on NIM in the conventional banking industry?
- 9) Do green loans, CSR funds, deposit insurance premiums, and total assets have a significant effect simultaneously on ROA in the conventional banking industry?
- 10) Do green loans, CSR funds, deposit insurance premiums, and total assets have a significant effect simultaneously on NIM in the conventional banking industry?

1.2 Research Purpose

Based on how the problems have been put forward, the following are theintended objectives of this research:

- To know whether green loan significantly affect on ROA in conventional banking industry.
- To know whether CSR funds significantly affect on ROA in conventional banking industry.

- To know whether deposit insurance premium significantly affect on ROA in a conventional banking industry.
- To know whether total assets significantly affect on ROA in conventional banking industry.
- 5) To know whether green loan significantly affect on NIM in conventional banking industry.
- To know whether CSR funds significantly affect on NIM in conventional banking industry.
- To know whether deposit insurance premium significantly affect on NIM in conventional banking industry.
- To know whether total assets significantly affect on NIM in conventional banking industry.
- To know whether green loan, CSR funds, deposit insurance premium, and total assets have significant affect simultaneously on ROA in conventional banking industry.
- To know whether green loan, CSR funds, deposit insurance premium, and total assets have significant affect simultaneously on NIM in conventional banking industry.

1.3 Research Benefit

This research offers a number of benefits to a broad spectrum of stakeholders, including but not limited to:

1.3.1 Theoretical Benefit

The purpose of this research was to make a positive academic impact by giving information for further studies. Determine the variables that have an impacton the environment, social, governance, and disclosure of profitability in conventional banks located in Indonesia. It is anticipated that the findings of this research will provide a theoretical contribution to the framework of the factors that contribute to the occurrence of environmental, social, and governance (ESG). Knowledge regarding ESG disclosure on financial performance in conventional banks in Indonesia is another benefit that can be gained from this research.

1.3.2 Practical Benefit

In addition to the theoretical benefits, it will be expected that this research willalso be beneficial in the following areas:

- 1) For companies, the results of this study are likely to be put to use as additional insight for companies that ESG disclosure has an effect on the profitability of the company so that companies can maintain the consistency oftheir profit or, even better, increase the profitability. The research was conducted to examine the relationship between environmental, social, and governance disclosure and the profitability of the company.
- For investors, before investing their capital in banking companies, the findings of this research are likely to be utilized to provide alternative environmental, social, and governance considerations for corporations.
- 3) For the government, they ought to make regulations that are more stringent and include annual periodic checks to guarantee that ESG disclosure follows POJK 51 regarding sustainablefinance. Also hope this research could be as an evaluation for the government.

1.4 Systematic of Final Project Writing

Contains a brief description of research reports as well as a systematic section that is comprised of Chapters I through V in research reports.

a. CHAPTER I INTRODUCTION

The following section is a general, short, and clear explanation of what the study is all about. This chapter has the following parts: Overview of research objects, research background, problem formulation, research objectives, research benefits, and systematization final project writing.

b. CHAPTER II LITERATURE REVIEW

This chapter has theories that range from general to specific. They are supported by up by research from the past and are followed by a study framework and, if necessary, a hypothesis

c. CHAPTER III RESEARCH METHOD

This chapter discusses the approaches, methods, and techniques that are used to gather and analyze study results. This chapter talks about the different kinds of research, how variables are operationalized, populations and samples (for quantitative research) or social situations (for qualitative research), data collection, validity and reliability tests, and techniques for analyzing data.

d. CHAPTER IV RESULTS AND DISCUSSION

The study's results and comments are given in a way that makes sense based on how the problem was stated and what the goals of the research were. Each section has its subtitle. This chapter is split into two parts. The first part shows the results of the study, and the second part talks about or analyses the results. Every part of the talk should start with the results of analyzing the data, then explain what that means, and then conclude. In the discussion, it should be compared to other studies or theories that are important.

e. CHAPTER V CONCLUSIONS AND SUGGESTIONS

The conclusion provides a response to the research question, which is then transformed into a recommendation that is associated with the beneficial effects of the research itself.