

# Sustainable Finance: A Strategy to Increase Good Corporate Governance and Company Value in The Banking Industry

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## Abstract

This paper aims to examine the effect of sustainable finance on the implementation of good corporate governance and corporate value creation. Environmental damage due to company activities is increasingly worrying. The sustainable finance policy will test the extent to which the implementation of good corporate governance is going well. The success of the sustainable finance policy will ultimately increase the company's value [PMO1]. The [PMO2] results of the analysis show that sustainable finance has a positive impact on the implementation of good corporate governance where sustainable finance will be successful if corporate governance is well implemented, as well as corporate value, where investors or the public will have a positive influence on the company's seriousness in implementing financial programs. sustainable and corporate value. [PMO3] This study is hoped to be an input for the government and banks in supporting environmental protection.

*Keywords— Sustainable finance, Banking, environment, GCG, Corporate Value*

## Abstrak

Makalah ini bertujuan untuk menguji pengaruh keuangan berkelanjutan terhadap penerapan tata kelola perusahaan yang baik dan penciptaan nilai perusahaan. Kerusakan lingkungan akibat aktivitas perusahaan semakin mengkhawatirkan. Kebijakan keuangan berkelanjutan akan menguji sejauh mana penerapan tata kelola perusahaan yang baik berjalan dengan baik. Keberhasilan kebijakan keuangan berkelanjutan pada akhirnya akan meningkatkan nilai perusahaan. Hasil analisis menunjukkan bahwa keuangan berkelanjutan berdampak positif terhadap penerapan tata kelola perusahaan yang baik dimana keuangan berkelanjutan akan berhasil jika tata kelola perusahaan dilaksanakan dengan baik, begitu pula dengan nilai perusahaan, dimana investor atau masyarakat akan berpengaruh positif terhadap keseriusan perusahaan dalam melaksanakan program keuangan. nilai berkelanjutan dan perusahaan. Kajian ini diharapkan dapat menjadi masukan bagi pemerintah dan perbankan dalam mendukung pelestarian lingkungan.

Kata kunci— Keuangan berkelanjutan, Perbankan, lingkungan, GCG, Nilai Perusahaan

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## I. INTRODUCTION

Currently, sustainable development is an issue that is widely discussed in the world economy. The development of an increasingly developing economic development must be able to go hand in hand with various aspects such as environmental sustainability, economic transformation, overcoming poverty and creating justice. This is what encourages the United Nations (UN) to collaborate with countries in the world, businesses and communities to create a sustainable development framework. In the last two decades, a development that solely targets economic growth has received a lot of attention, especially with the increasing issue of environmental degradation, the issue of widening social inequality, and the issue of climate change with all its implications. The negative impacts arising from the economic development process have prompted the initiation of sustainable development that prioritizes harmony in economic, environmental, and social aspects.

At the year meeting of the G20 countries held in Pittsburg in 2009, Indonesia has agreed on a commitment to reduce the impact of greenhouse emissions. In the statement of commitment made in the National Action Plan for the Greenhouse Movement, Indonesia is willing to reduce the impact of greenhouse emissions by 26% and with assistance from international parties by 41%. The plan states that a 26% reduction in greenhouse gas emissions will be obtained from forestry and peatlands by 50%, transportation and energy by 3.8%, agriculture by 18%, industry by 1.8%, and waste by 5.9%. In addition, the government has established a sustainable development framework consisting of economic aspects, social aspects, environmental aspects and institutional aspects in the Medium and Long Term Development Plan.

The banking industry certainly has a role to play in making this commitment a success through a sustainable finance program. Sustainable Finance is becoming a global trend which is a new paradigm in the world of banking and other financial institutions that support the implementation of sustainable development. Sustainable development is a development effort based on three aspects of orientation, namely profit (profit), people (social community relations), and the planet (protection of natural resources and the environment (Hadad and Maftuchah,

2015). This program is carried out through cooperation with various parties to create financial support for industries that apply the principles of sustainable finance. The sustainable finance program not only seeks to increase the portion of financing but also to increase the resilience, competitiveness of financial service institutions, and corporate value. This program will also assist financial service institutions in reporting Good Corporate Governance, which of course will increasingly make the direction of sustainable finance go hand in hand with one another Good Corporate Governance (GCG) is by definition a concept that regulates and controls a company that creates added value (value-added) for all stakeholders (Monks, 2003). The benefits of implementing GCG are important because the company will get full confidence in the investment climate so that the sustainability of the company's life can be maintained.[PMO4]

Banking as a financial service institution has a big share in providing some funds to be managed by the public, be it state, private or foreign. Each bank is expected to contribute to the creation of sustainable finance that is consistently implemented. Given the last few decades, several credit funds that have been distributed to corporations and retail have contributed NPL (Non-Performing Loans) figures due to business failures based on business policies that violate environmental regulations and corporate governance.[PMO5]

The consistency of banking in implementing Sustainable Finance is expected to be able to encourage companies to be able to face the challenges of emerging risks from sectors that are vulnerable to violations of activity lines that are considered to be exploring the environment significantly. An active policy in implementing this program can at least be the spearhead for companies that are active in environmental protection, social and corporate governance so that the objectives of corporate responsibility and corporate value can grow optimally.

Sustainable finance is a global trend, a new paradigm in the world of banking and other financial institutions supporting the implementation of sustainable development. Sustainable development is a development effort based on three aspects of orientation, namely profit, people (community social relations), and the planet (protection of natural resources and environment (Hadad and Maftuchah, 2015: 90). The term is often known as triple bottom line. According to OJK (2014: 16), sustainable finance has five dimensions, namely the achievement of industrial, social and economic advantage in order to reduce the threat of global warming and prevent other environmental and social problems; the shift of targets towards a low-carbon economy competitive; the promotion of environmentally friendly investment in various business / economic sectors, and provision of support for the implementation of the 4P development principles in Indonesia (pro-growth, pro-jobs, pro-poor, and pro-environment). In this paradigm, the service finance industry can boost the sustainable financing and investment programs, such as the projects of biogas, micro hydro, hydroelectric power, solar power, wind power, organic farming, and so on. The sustainable finance received a fairly broad response, namely from various world organizations that are advocating sustainability, including the standard initiators. In Indonesia, the Financial Services Authority has launched a roadmap to provide a work plan guidance for a sustainable finance program. This roadmap is spelled out into two periods of achievement, medium term (2015-2019) and long term (2015-2024). Sustainable finance consists of four principles, namely (1) risk management, (2) principles of sustainable priority economic sector development, (3) principles of environmental and social governance and reporting, (4) principles of capacity building and collaborative partnerships (OJK, 2014). In sustainable finance, there are also incentives in form of prudential incentives which include risk mitigation fixed assets by taking into account the risk mitigation mechanism in 2015-2016 and in 2016-2018 that will encourage government to provide fiscal incentives, such as tax holidays and feeds-in-tariff (OJK, 2020).[PMO6][PMO7][PMO8][PMO9]

## **II. LITERATURE REVIEW ]**

[PMO10]

### *Sustainable Finance*

According to Jeucken, M (2001) Sustainable Finance is the implementation of credit management or the provision of financing and investment in all sectors of the financial services industry by incorporating economic, social, and environmental risk factors in a sustainable manner, where these policies have become part of the portfolio of the financial services industry concerned. Sustainable finance is a series of contributions from elements in the financial services business in a sustainable manner that has an impact on the economic, social and environmental sectors (OJK, 2014).

The concept of sustainable finance originates from the philosophy of social bank business process (Relaño, 2011). Social bank is a new financial institution that believes the profitability not only be measured by financial returns but also by social benefits. This view distinguishes social banks from banking institutions in general. This makes the financial institution to be called a social bank or ethical bank. For this new type of financial institution, maximizing profits is not the only goal to achieve through business activities. But, social and environmental added value is also a goal to achieve. Hence, different from the banking institutions in general, the social bank is

balancing profitability and ethics. In other words, social bank integrates ethical values into all of its financial projects.

Social bank is a banking institution that performs CSR with a commitment to sustainable finance as part of the involvement of this financial institution in sustainable development. In this financial institution, the CSR initiative is not only a marketing strategy to get customers, but also an integral part of its overall business activities, so that the social bank usually refuses to participate in speculative activities in capital market. It views this activity causes many international crises, social inequality, environmental problems, and so on. In other commercial banks, social bank participation in capital market is generally insignificant, because it is not its main business activity. Even if it is involved in capital market activities, the intention is only for long-term investment and not for a speculative activity. Thus, the main activity of this new financial institution is to focus on the origin business of a bank, namely collecting savings and distributing loans. Social banks give priority to social, ethical or environmental dimensions in each of their financial projects. It is different from banks in general which practice only one principle, namely focusing on financial performance, social banks place three principles, namely environmental, social and financial performance. The special attention of social bank is on the fields of social and environmentally-friendly housing, organic agriculture, development of alternative energy, UMKM, and others (Bernardus, 2016).

Sustainable finance has five components, namely the achievement of industrial excellence, an economic component to limit the impact of global warming, a social component, and reduce environmental damage and other social components; transforming achievements to lead to low-carbon, competitive economic activities; promote in all business sectors or investment economies that are environmentally friendly, and encourage the implementation of 4P which are the principles of development in Indonesia (pro job, pro growth, pro environment and pro poor) (OJK, 2014)

### *Good Corporate Governance*

According to Shaw (2003), in the problem of corporate governance there are 2 theories that can be used, namely management theory and agency theory. Stewardship theory explains that philosophically humans have honesty and integrity, honesty and are responsible for every activity. So that in theory stewardship a manager must be able to be trusted to take policies or actions that are best for the benefit of society and shareholders.

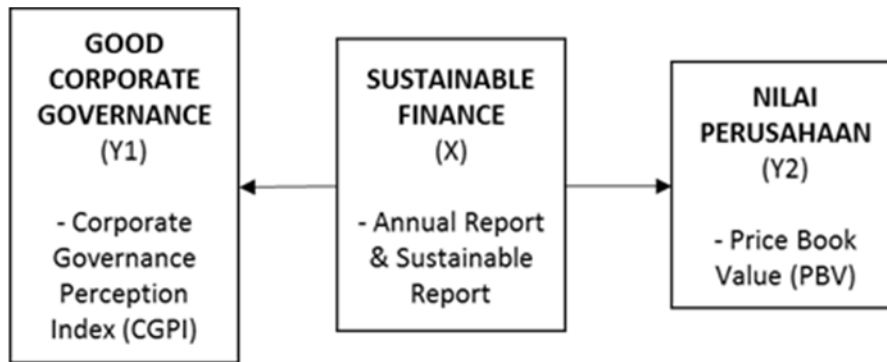
In subsequent developments, agency theory received a broader response because it was seen as more reflective of existing realities. Various thoughts on corporate governance develop based on agency theory in which management is carried out in full compliance with various applicable rules and regulations. Good Corporate Governance (GCG) is definitively a system that regulates and controls companies that create added value (value-added) for all stakeholders (Monks, 2003). Meanwhile, according to Daniri (2005), Good Corporate governance is the principle of how to organize management acts appropriately in conducting its business. Monks (2003) "states that GCG is a system that manages and regulates company activities to create added value for all interested parties in the company".

### *The value of the company*

A company is said to have good value if the company's performance is also good. With good performance, it will be able to generate higher profits and can increase the prosperity of owners and shareholders so that it will increase company value. Firm value is a very important variable because the higher the firm value the higher the shareholder's prosperity (Gapenski and Enhard, 2010).

Firm value is the investor's perception of the company and is often associated with stock prices, where the stock price is high, the company value is also high (Wahyudi and Pawestri, 2006). According to Husnan (2015), the definition of company value is as follows: "Company value is the value that investors need to make investment decisions that are reflected in the company's market price." Jogiyanto (2010) explains that "There are several values associated with stocks, namely book value, market value, and intrinsic value."

*Conceptual Framework* [PMO11][PMO12][PMO13]



## 2. HYPOTHESIS DEVELOPMENT

### a. *The Influence of Sustainable Finance on Good Corporate Governance*

Sustainable Finance as a program to facilitate the implementation of banking and financial service institutions in supporting environment-based, social, and corporate governance-based finance. This program is also believed to be able to simplify the design of every banking and financial service institution to reveal Good Corporate Governance which of course in the design of a sustainable finance program also includes corporate challenges in addressing the environment, social and governance which have profound implications for the business, economy, and society at large, along with risks. as well as the opportunities that must be addressed if long-term economic and social growth and stability are to be sustained. Dario's research results (2015) reveal that the implementation of CSR will greatly influence a company's sustainable finance policy

### b. *The Influence of Sustainable Finance on Company Value*

Every company engaged in banking or financial services has its way of increasing its corporate value. One of the programs that are being intensified to provide an open space for financial service institutions to prioritize environmental, social, and governance is expected to strengthen their corporate image which is sensitive enough to respond to current issues in society.

Sustainable finance or sustainable finance provides a positive value for the sustainability of a company in supporting long-term stability and global economic development, the banking sector or financial services institutions need to change their attitudes and actions significantly to encourage more responsible and sustainable business practices. Leading companies, the United Nations, the OECD / Organization for Economic Co-operation and Development, the G20 / Group of Twenty, and certain regulators and investors alike agreed that environmental and social issues need to be taken into account in investment decisions and corporate decision-making processes, in addition to traditional financial metrics.

Their activeness in this program enhances the image of those who are also active in global issues that have been intensified in recent decades..[PMO14]

## III. RESEARCH METHODOLOGY

This research is classified in causality research which reveals the influence of sustainable finance on Good Corporate Governance and company value.

The dependent variable for the sustainable finance index uses content analysis based on the items required in the guidelines by International Financial Corporation (IFC). The index calculation follows Haniffa and Cooke (2005) with the formula:

$$SFI = \frac{\sum X_{ij}}{n_j}$$

Information: SFI = Sustainable finance index;  $n_j$  = number of items for firm j,  $n_j = 32$ ;  $X_{ij} = 1$  if the element is disclosed; 0 if the element is not disclosed

The measurement of the Good Corporate Governance variable is proxied by the size of the board of commissioners, the number of board meetings, independent commissioners, audit committee meetings, and the nomination and remuneration committee (measured by dummy variables, namely seeing the existence of these

committees in the annual report. If the company has a Nomination and Remuneration Committee) it will be given a scale of one or 1 whereas in the absence of this committee they will be given a score of zero or 0).

Corporate value is the dependent variable used in this study. The stock price is the benchmark in determining the value of the company. Measurement of company value is measured by a ratio, namely the value of Tobin's Q, which was developed by Klepper and Love (2002) in Murwaningsari (2009), namely: Tobin's Q = (MVE + Debt) / TA Tobin's Q = Firm value MVE = Year-end stock closing price x many common shares outstanding. Debt = Total Payable TA = Total book value of assets

The sample used in this study were 8 banking companies listed on the Indonesia Stock Exchange in 2020. Analysis of data using SmartPLS 3.0 [PMO15], [PMO16] [PMO17]

## RESULT ANALYSIS

### Validitas Diskriminan

Table 1. DISCRIMINANT VALIDITY

|             | GCG   | SUSTAINABLE | VALUE |
|-------------|-------|-------------|-------|
| GCG         | 0.768 |             |       |
| SUSTAINABLE | 0.586 | 0.653       |       |
| VALUE       | 0.226 | 0.633       | 0.655 |

Sources: Output result

Some researchers used discriminant validity as a test of construct validity (Bruhn et al., 2008; Mackenzie, Podsakoff, & Jarvis, 2005). If the intercorrelation value between variables in the model is less than 0.71, the discriminant validity is fulfilled (Mackenzie et al., 2005). The figure 1 above shows that all intercorrelation values between the variables in the model are smaller than 0.71 which means that the discriminant validity of all constructs is satisfied.

[PMO18]

### Test of Hypothesis

The test of hypothesis in the SmartPLS application uses bootstrapping technique. Researchers used a bootstrapping technique with resampling 500 times. Figure 2 presents the path coefficient and t-test value and significance. The significance level is 0.05.

Tabel 2. PATH COEFICIENT

|                     | Original<br>Sample<br>( O ) | Sample<br>Mean<br>(M) | Standard<br>Deviasi<br>(STDEV) | Standard<br>Error<br>(STREER) | T Statistics<br>(O/STERR) |
|---------------------|-----------------------------|-----------------------|--------------------------------|-------------------------------|---------------------------|
| Sustainable > GCG   | 0.847                       | 0.852                 | 0.025                          | 33.823                        | 0.000                     |
| Sustainable > Value | 0.796                       | 0.801                 | 0.038                          | 29.711                        | 0.000                     |

Source ; Output Result [PMO19]



Source: Smart PLS Analysis[PMO20][PMO21]

## DISCUSSION

Testing of the Sustainable Finance Regression Coefficient on Good Corporate Governance and Company Value shows that Sustainable Finance has a positive effect on Good Corporate Governance and Company Value. This is in line with previous research conducted by Chong and Freedman (2011), Setiawan (2012) and Al Tuwarij et al (2004). This can be seen how the implementation of Sustainable Finance is able to influence the role of banks, primarily in disclosing Good Corporate Governance. Banking siding with environmental sustainability by applying rules for granting credit to business sectors or activities that do not damage the environment and are committed to supporting environmental preservation. The banking sector currently plays a huge role in dealing with the risks of climate change by advancing the zero-carbon energy transition (Whitley et al. 2018; Chenet et al. 2019). The role of the banking industry in implementing sustainable finance cannot be separated from the implementation of good corporate governance. Managing a company by applying the rules that apply properly is proof of the support of the banking industry in protecting the environment (Dario, 2019).

Sustainable finance practices in the international scope show that policies related to sustainable finance have a positive impact on firm value (Qingrong et al., 2013). Likewise, the results of the study by Ayusso, et al. (2007) and Ani and Fredy (2017) who obtained results that the better the company's management plays a role in handling corporate social responsibility, the more effective it is. Through these results, it has been proven that the efforts of a good corporate governance mechanism with the size of the board of directors as a proxy can be a driving force for the implementation of sustainable finance disclosure in Indonesia. This research also proves that sustainable finance policy can increase firm value. Many studies show that good sustainable finance management can improve company performance. Proper implementation of sustainable finance in the banking industry will provide added value to the company and increase the company's productivity. This is in line with the results of research conducted by Shleifer and Vishny (1997), El-Faitouri (2014); and Ricky and Murhadi (2015).

Banks need to adapt themselves to the principles of sustainable finance because the business benefits can be felt in the long term (Hadad and Maftuchah, 2015). The concept includes environmental, social and governance factors in credit proposal preparation and credit risk ratings analysis to determine the debtor creditworthiness. Credit funding is also prioritized to develop environmentally friendly products and services that comply with international standards. In addition, banks understand that there is a growing global and national awareness related to the principle of sustainable financing which not only prioritizes the profit but also takes into account the important factors of the principle of respect for life.

Bank boosts sustainable financing programs for the economic growth of Indonesia which not only prosperous economically but also attentive to the principles of integrated social and environmental governance (OJK, 2020). Bank is committed to implementing sustainable finance principles that integrating environmental, social and governance aspects in daily operations by being involved in the pilot project 'First Movers on Sustainable Banking' initiated by OJK since 2015. In addition to developing environmentally friendly businesses, bank also encourages all employees and bank management to apply the principles of Reuse, Reduce and Recycle in performing daily operational activities. The routine initiatives bank applies include turning off lights and



computer monitors during recess, using a tumbler during meeting and cultivating double-sided printing for all kinds of documents. This is also a form of banking support for the national Go Green movement . Bank supports the credit extending in a number of sectors, such as renewable energy products, energy efficiency, and organic agriculture which is in line with the business growth and the creditworthiness of related businesses. The bank commitment to sustainable finance is manifested by increasing the portion of finance in a number of sectors such as environmentally friendly products, energy conservation and organic agriculture. In applying sustainable finance principles, bank extends credit to a number of sectors such as renewable energy products, energy efficiency and organic agriculture in line with business growth and the creditworthiness of related businesses. However, the entire process of credit extending in banking continuously applies the principles of sustainable finance. The bank commitment in applying sustainable finance principles that integrates environmental, social and governance aspects is realized by increasing the sustainable financing portfolio every year. Bank gives priority to finance sectors of sustainable agriculture, green infrastructure, sustainable forestry, renewable energy, industrial recycling, energy efficiency, and green buildings. In addition, bank commitment to support government development programs such as financial inclusion is realized by distributing to Public Business Credit a financing portion of 103.55 billion per December 2017 (OJK, 2020). In every decision to make financing, banks always apply the principle of prudence by paying attention to all regulations and prevailing laws including the principles of sustainable finance. Bank is active to support financing on sustainable projects. Until 2018, around Rp 7.56 trillion has been disbursed by bank to support sustainable projects. Bank is always open to possibility of supporting the financing of various sustainable projects to ensure sustainable economic growth in Indonesia (Ani dan Fredy, 2017).

The implementation of sustainable finance will also ultimately have a positive impact on company value in the eyes of investors because the issue of environmental damage caused by the uncontrolled exploration of companies is the main source of a lot of environmental damage and the emergence of natural disasters has begun to become a consideration for banks to limit funding ( Al-Najjar (2012) Pfeiger et al (2005). Attract the attention of the public, especially investors in their role in building banking that is consistent in implementing environmental protection policies that have been regulated by the Financial Services Authority regulator (Review, 2019). [PMO22][PMO23] [PMO24]

## CONCLUSION

This study aims to test and analyze the implementation of Sustainable Finance on Good Corporate Governance and Corporate Value. From the formulation of the proposed research problem, the data analysis that has been carried out can be drawn several conclusions, namely:

Based on a simple linear regression analysis, it turns out that the results of the study show a regression equation, namely  $Y = 20,673 + 0.684 + 0.468$ , which means that if the implementation of Sustainable Finance is carried out consistently it will affect the improvement of Good Corporate Governance and Company Value, respectively 68,4 and 46,8% in banking development.

Based on the partial analysis (t-test), it turns out that the results of the study prove that the independent variable Sustainable Finance has a significant effect with  $t (6.272) > t \text{ table } (1.996)$  on banking Good Corporate Governance. Based on a partial analysis (t-test), it turns out that the results of the study prove that the independent variable Sustainable Finance has a significant effect with  $t (9.763) > t \text{ table } (1.996)$  on the value of banking firms.

## LIMITATION

This study has tried to describe the effect of implementing sustainable finance on good corporate governance and corporate value in the banking industry in Indonesia, however limitations are found in this study. Such is the limitation in this study because researchers only use reports on the implementation of the sustainability fianace for only 1 year, as well as the sample used only for banks that are in the top 4, while there are still several banks involved in sustainable finance programs in Indonesia. The selection of banks in the top 4 rankings in Indonesia considering the impact of their large lending activities which can have a major impact on the success of implementing sustainable finance, but on the other hand raises limitations because medium-scale banks involved in the sustainable finance program are not included this research sample so that the results obtained can not describe in general. Likewise, the method used only uses the results of the questionnaire to competent parties in this sustainable finance program, whereas in expressing the application of good corporate governance and corporate value, several methods are used in other studies. disclosure of Good Corporate Governance is obtained from the author's interpretation in reading the sample companies' annual reports so that the interpretation contains

an element of subjectivity. From the limitations of the research disclosed, suggestions for further research can be given, namely: First, increasing the number of samples and the year of observation that is more than 2 years. Second, the interpretation of the Corporate Governance Disclosure Index must be carried out by more than one person to reduce subjectivity, so that the resulting index can be more objective. Third, to strengthen the research results, further researchers need to add several other variables such as sustainable management or corporate social responsibility [PMO25]

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