

## CHAPTER 1 INTRODUCTION

### 1.1. Overview of Research Object

The primary goal of this study is to investigate the relationship between ESG disclosure and the profitability of Indonesian sharia commercial banks. Based on Sharia Banking Law No. 21 of 2008 and OJK Regulation No. 51/POJK.03/2017. To achieve this goal, we will use secondary data from the financial statements of Indonesian sharia commercial banks, as well as information on their ESG disclosure procedures. Table 1.1 contains a list of Sharia Commercial Banks (BUS) that are registered in OJK as of 2022.

**Table 1.1 List of Sharia Commercial Banks in Indonesia**

No.	Sharia Commercial Bank
1.	PT. Bank Aceh Syariah
2.	PT BPD Riau Kepri Syariah
3.	PT BPD Nusa Tenggara Barat Syariah
4.	PT. Bank Muamalat Indonesia
5.	PT. Bank Victoria Syariah
6.	PT. Bank Jabar Banten Syariah
7.	PT. Bank Syariah Indonesia, Tbk
8.	PT. Bank Mega Syariah
9.	PT. Bank Panin Dubai Syariah, Tbk
10.	PT. Bank Syariah Bukopin
11.	PT. BCA Syariah
12.	PT. Bank Tabungan Pensiunan Nasional Syariah
13.	PT. Bank Aladin Syariah, Tbk

Source: (OJK, 2022)

According to Table 1.1, there are 13 Sharia Commercial Banks that listed in OJK as of 2022. This Research will examine banks that listed within the period of 2020 – 2022, when there has been a greater awareness of ESG issues among investors and other stakeholders.

Islamic or Sharia banking refers to a system of banking that is consistent with the principles of Islamic law (Sharia). In general, this means a system that is free from Riba (interest), ensures risk sharing, does not fund activities considered Haram (prohibited by Islam), and maintains ethical standards for investments.

The principles and criteria of Sharia banking in Indonesia are mainly governed by the Otoritas Jasa Keuangan (OJK) and Bank Indonesia. They stipulate the following principles for operation:

- 1) **Riba-Free Operations:** Islamic banking strictly follows the principle of prohibition of Riba (interest). In the context of Indonesian Sharia banking, this means transactions are structured on an interest-free basis. For instance, instead of lending with an interest rate, a Sharia bank in Indonesia would use profit-sharing, leasing, or sale and buyback agreements. The prohibition of Riba ensures fairness and equity in financial transactions (OJK, 2014).
- 2) **Risk-Sharing:** Unlike conventional banking where the borrower bears all the risk of failure, Sharia banking promotes risk sharing between the provider and user of capital. The bank and the customer share the risk of any investment on agreed terms and divide any profits or losses between them. This principle promotes justice and discourages excessive risk-taking (OJK, 2014).
- 3) **Asset-Backing:** Islamic banking requires that all financial transactions must be tied to a real, tangible asset. This means that financial speculation or transactions involving uncertainty, known as Gharar, are prohibited. The asset-backing principle ensures that Islamic banking supports productive, asset-based financing and discourages the creation of debt through unsecured lending (OJK, 2014).
- 4) **Ethical Investments:** Indonesian Sharia banks are required to operate under strict ethical guidelines. They cannot support businesses or transactions related to activities deemed Haram (forbidden) under Islamic law, such as alcohol, pork, gambling, etc. This ensures that the bank's operations align with the social and moral values of the community it serves (Bank Indonesia, 2008).
- 5) **Transparency:** According to the regulations set by Bank Indonesia, Sharia banks must maintain full transparency in their transactions. Both parties in a transaction must have a clear understanding of all terms and conditions of the

contract. This promotes trust and mitigates the chance of exploitation or fraud (Bank Indonesia, 2008).

There are also types of Sharia Banks, such as below:

1) Sharia Commercial Banks (Bank Umum Syariah): These banks fully operate on the principles of Sharia law. The products and services offered by these banks, ranging from savings accounts, loans, and various investment products, are all in compliance with Sharia law. As of 2022, there are several Sharia Commercial Banks operating in Indonesia including Bank Syariah Mandiri, BNI Syariah, and BRI Syariah (Bank Indonesia, 2008).

2) Sharia Business Units (Unit Usaha Syariah): These are divisions within conventional banks that offer products and services compliant with Sharia law. They provide an option for customers within a conventional banking framework who wish to conduct banking activities in line with Islamic principles. Many conventional banks in Indonesia have such units, providing a range of Sharia-compliant services to their customers (Bank Indonesia, 2008).

3) Sharia People's Financing Bank (Bank Pembiayaan Rakyat Syariah - BPRS): This is a microfinance institution that provides sharia-compliant financing to people who might not typically have access to banking services. BPRS can serve as a financial intermediary in rural and less-developed regions where large commercial banks may not be present. They offer a variety of products and services such as savings, deposits, and financing facilities, all in accordance with Sharia principles. BPRS play a critical role in promoting financial inclusion and enhancing the resilience of the rural economy in Indonesia (Bank Indonesia, 2008).

This current research uses Sharia Commercial Banks (BUS) to represent Indonesia sharia banks. Bank Umum Syariah (BUS) may be chosen as the subject of study over Unit Usaha Syariah (UUS) when conducting ESG (Environmental, Social, and Governance) research, for the following reasons:

1) Independence: BUS is a standalone Islamic bank with its own legal basis, while UUS is a part of conventional banks that operate with Islamic principles (Bank Indonesia, 2008). This independence grants BUS greater autonomy and

freedom in aligning its operations and governance with Sharia principles, providing a clearer and more defined environment for the study of Islamic finance principles.

2) Separation: Transactions and reports of UUS are kept separate from conventional banks, as there is no mixing of transactions allowed between the two entities, although consolidation is still performed with the parent bank. UUS does not have a separate legal establishment from its parent bank, as it operates as a division or branch of the bank (Bank Indonesia, 2008) This distinction aids in isolating the effects of ESG disclosures, thus enabling a more precise analysis.

3) Readiness and Maturity: The government encourages conventional banks with UUS to separate them and establish them as independent BUS. This indicates that BUS is more prepared to conduct its business activities due to its clear legal basis (Center for Indonesian Financial Sector Policy, 2017) This maturity not only signifies that BUS is operating at a more advanced stage but also positions it as an ideal subject for assessing the alignment and impact of ESG factors in Islamic banking.

4) Availability of data: BUS has more data and information available for analysis compared to UUS, as BUS is a standalone Islamic bank (Muzawir, et al., 2018)

The choice of BUS as the subject of study aligns with the research's aim to explore ESG disclosures within a purely Islamic banking context, facilitated by its independence, clear separation from conventional banking, readiness, availability of data, and broader market relevance.

According to OJK Regulation No. 51/POJK.03/2017 Chapter IV Article 10 Point 6-b, it is stated that Lembaga Jasa Keuangan (LJK) that is categorized as Bank Umum Kegiatan Usaha (BUKU) 1 & 2 Banks in Indonesia must submit sustainability report officially starting from 1<sup>st</sup> January 2020, apart from their annual report. The term BUKU itself is categorized by the amount level of core capital owned by the banking companies and according to Bank Indonesia (2012), BUKU 1 are banks with core capital below 1 trillion while BUKU 2 are banks with core capital ranging between 1-5 trillion. Although this regulation was stated in 2017, most of the Sharia banks that are categorized in BUKU 1 & 2 only started to

publish their sustainability report since 2020 because of the regulation stated above. Which based why this study examines the impact of ESG disclosure on the profitability of sharia commercial banks (BUS) in Indonesia only from 2020 to 2022.

Apart from PT. Bank Aceh Syariah and PT. Bank Muamalat Indonesia who already published their sustainability report since 2017, also PT. Bank Tabungan Pensiunan Nasional (BTPN) Syariah who published since 2019, because of their greater sense of awareness and significance towards ESG which increase their contribution to the sustainability development programs, other sharia banks selected in this study (as presented in Table 1.1) took their remaining time before the appointed year (2020), to face and adjust ESG within their internal companies. Difficulties including different understanding capacity about ESG matter between workers, the measurement inadequacy to evaluate the efficiency impact from saving renewable resource, and other challenges are often met (BCA Syariah Sustainability Report, 2020 & Bank Panin Dubai Syariah, 2020). Therefore, necessary steps like developing internal capacity to prepare human resource who is capable in implementing sustainable finance, changing the company's operational and management, even adjusting the vision and mission of company are taken by BUS to implement sustainability goals.

## **1.2 Research Background**

The present research endeavors to examine the impact of Environmental, Social, and Governance (ESG) disclosure on the profitability of Sharia Commercial Banks (BUS) in Indonesia over the period of 2020 to 2022. It investigates compliance between the regulations governing sharia commercial banking in Indonesia and the Environmental, Social, and Governance (ESG) regulations in Indonesia. Specifically, by examining the correlation between ESG proxies, such as green loans, Corporate Social Responsibility (CSR) funds, and Deposit Insurance Premium (DIP), and total asset serves as the control variable. This study also employs Return on Assets (ROA) and Net Profit Margin (NPM) as the principal dependent variables. With aims to offer insights into the correlation between the

disclosure of environmental, social, and governance (ESG) factors and the performance of sharia commercial banks operating in Indonesia.

In recent years, there has been a notable shift in the global financial landscape, whereby financial institutions have placed greater emphasis on integrating Environmental, Social, and Governance (ESG) considerations into their decision-making processes (Eccles & Serafeim, 2013). It was their effort to implement the Paris Agreement and United Nations 2030 Agenda for Sustainable Development that was made based on the occurring ecological issues, including climate change, pollution, and natural resource depletion which heightened the necessity for sustainable development (Zhang & Jin, 2022). Indonesia itself is also confronted with environmental obstacles, which underscore the necessity to implement sustainable business practices and integrate environmental, social, and governance (ESG) considerations into their decision-making frameworks (Purniawati et al., 2020). The increasing public consciousness regarding environmental concerns has led to a potential advantage for financial institutions that exhibit a dedication to sustainable practices through Environmental, Social, and Governance (ESG) disclosure. According to Flammer (2019), such institutions may enhance their reputation and appeal to investors who prioritize environmental and social responsibility.

Disclosure of economic, environmental, and social aspects is required as a part of a comprehensive report for the society and companies in decision making as well as environmental sustainability where the companies conduct their business activities (Saputra et al., 2017). The Financial Services Authority of Indonesia (OJK) has implemented Environmental, Social, and Governance (ESG) guidelines for all financial entities. According to OJK Regulation No. 51/POJK.03/2017, the implementation of sustainable finance mandates that banks must incorporate sustainable business practices, disclose banks activity, divulge their environmental, social, and governance (ESG) performance, and integrate ESG factors into their risk management systems (OJK, 2017). The policy aligns with the worldwide movement of integrating ESG considerations into the financial industry, as

exemplified by the European Union's Non-Financial Reporting Directive (Directive 2014/95/EU) and the Principles for Responsible Investment (PRI) supported by the United Nations (European Commission, 2014) (PRI, 2021).

According to data statistic from Bank Indonesia (2020), Indonesia, being the most populous Muslim-majority nation globally, is currently experiencing a notable expansion in its sharia commercial banking industry. The sharia commercial banking industry in Indonesia is one of the financial entities that is subjected to regulatory oversight by the Financial Services Authority (OJK) and Bank Indonesia. These governing bodies have established a framework of regulations and guidelines, including the 2015 OJK Regulation No. 11/POJK.03/2015, which outlines the principles of Sharia Governance for Sharia Financial Institutions (OJK, 2015). Sharia financial institutions, which adhere to sharia principles, have been recognized as trailblazers in integrating ethical and socially responsible measures into their business activities (Belal et al., 2015). With both of them sharing commonalities that encompass an ethical and responsible conduct toward the environment and society.

When the previous Covid-19 Pandemic occurred, the bank industries performance was affected by various factors, for instances the severity of the pandemic, pre-crisis conditions of banks, also the institutional environment and financial development of countries (Xiazi & Shabir, 2021). However, the pandemic became the catalyst that resurge sustainable sukuk and investment funds, growing a large amount of asset (The Jakarta Post, 2021). By incorporating ESG into their decision-making process, sharia banks could increase their resilience to environmental and societal problems such as climate change or pandemic, increase the trust and loyalty from customer and stakeholder, and also improve risk management. It offers sharia banks an access to new sources and gives a competitive edge because of its fast-growing potential market by leveraging their capabilities in Sharia-compliant instruments like sukuk and waqf to meet the demand for sustainable finance (SPGlobal). Several banks has conducted an ESG-based practice, like BNI Syariah who issued green sukuk to finance renewable

energy project or Bank DBS Indonesia whom launched a sharia-based equity fund that aligned with ESG principles with other company (DBS, 2021).

As mentioned previously, according to Bank Indonesia Law No.21 of 2008 on Sharia Banking there are three types of Sharia Banks which are Sharia Commercial Banks (Bank Umum Syariah), Sharia Business Units (Unit Usaha Syariah), and Sharia People's Financing Bank (Bank Pembiayaan Rakyat Syariah - BPRS). In the Islamic banking landscape of Indonesia, the distinction between Bank Umum Syariah (BUS) and Unit Usaha Syariah (UUS) becomes particularly salient when analyzed through the lens of Return on Assets (ROA) and total assets, two metrics that resonate deeply with the principles of Environmental, Social, and Governance (ESG). Return on Assets (ROA) and total assets are two important indicators that reflect the profitability and size of a bank in terms of financial performance. BUS, as an independent entity, typically enjoys greater autonomy, transparency, and potentially a larger asset base, thus providing a more transparent platform for integrating and assessing ESG principles. Its independence allows for a clearer correlation between adherence to ESG values and ROA, reflecting the efficiency of managing assets in accordance with social responsibility and environmental sustainability.

In contrast, UUS, operating as part of a conventional bank under Sharia principles, often presents a more complex scenario. The consolidated nature of UUS with its parent bank may result in potential conflicts or misalignment in evaluating ROA from an ESG perspective, given that the influence of the parent bank's policies may not always be in harmony with ESG principles. Furthermore, UUS total assets, might intertwined with the larger conventional banking structure, might restrict a full-scale application of ESG principles across all assets. This integrated operation may lead to complexities in tracking and assessing the adherence to ESG goals. As such, the contrasting structures of BUS and UUS offer divergent insights into how ESG principles can be realized within Islamic banking. The independent operation of BUS appears to provide a more robust and transparent framework for studying the interplay between Islamic finance, asset efficiency, and ESG objectives,



whereas UUS complexity might challenge such direct analysis. These intricacies underline the importance of a nuanced understanding of these two entities in any exploration of ESG's impact on the profitability and sustainability of Islamic banking.

The present investigation utilizes three ESG indicators, namely green loan, CSR funds, and Deposit Insurance Premium (DIP). The term "green loan" pertains to the provision of loans by financial institutions to fund initiatives that advance ecological sustainability, including but not limited to green buildings and renewable energy projects (Yin et al., 2021). Green loan refers to financial loans extended by financial institutions to businesses that prioritize eco-friendly initiatives, including but not limited to renewable energy, pollution control, and resource preservation. The objective of these credits is to help towards the advancement of sustainable development and the advocacy of ecologically conscious business strategies (Yin et al., 2021). Green loan function as a surrogate for the ecological dimension of Environmental, Social, and Governance (ESG) considerations, as they embody the bank's dedication to funding sustainable initiatives and mitigating the adverse environmental effects of their investments.

CSR is a rational and structured program and parts of business activities. Performance of CSR must be measured to examine whether the program has achieved the goals. Performance measurement of CSR is important to inform the companies whether their CSR programs are right on target and successful to create multiplying effects that lead to improvements for the companies and their surroundings. (Krisnawati et al., 2014). Corporate Social Responsibility (CSR) funds pertain to the monetary resources designated by a corporation to help social, environmental, and communal endeavors. The allocation of these funds towards diverse objectives, including but not limited to education, healthcare, poverty reduction, and environmental preservation, serves as evidence of a corporation's dedication to fulfilling its social responsibilities (Yoestini et al., 2018). Corporate Social Responsibility (CSR) funds are utilized as a surrogate for the social component of Environmental, Social, and Governance (ESG) as they signify the

endeavors of the banking institution to make constructive contributions to society and tackle social predicaments.

Deposit Insurance Premium (DIP) is a form of financial compensation that banks provide to safeguard depositors from the potential hazards of bank insolvency, which may result in substantial social and economic ramifications (Demirgüç-Kunt et al.,2015). The Deposit Insurance Premium (DIP) is a payment made by financial institutions to a deposit insurance agency. This payment serves as a safeguard for depositors in the event of a bank's insolvency. According to Demirgüç-Kunt et al. (2015), the DIP metric functions as an indicator of a bank's risk management practices and overall stability. The utilization of DIP serves as a surrogate for the governance facet of Environmental, Social, and Governance (ESG) as it indicates the bank's dedication to upholding robust risk management protocols and safeguarding the funds of depositors.

The present study employs green loan, CSR funds, and DIP as surrogates for ESG disclosure, as they serve as indicators of the environmental, social, and governance dimensions of a financial institution's activities. The study endeavors to examine the influence of ESG disclosure on the profitability of sharia commercial banks in Indonesia by concentrating on these proxies. This research seeks to offer significant perspectives on the correlation between sustainable business practices and financial performance. The Environmental, Social, and Governance (ESG) criteria are utilized as the primary indicators to evaluate the ethical and sustainable impact of a company or investment. Investors and stakeholders are increasingly considering these factors as a means of evaluating the long-term sustainability and social accountability of enterprises (Busch & Lewandowski, 2018).

Other than that, the variables under consideration in this study are Return on Assets (ROA) and Net Profit Margin (NPM), both of which serve as indicators of bank profitability. The Return on Assets (ROA) metric is a financial performance indicator utilized to evaluate a company's profitability in relation to its overall assets. The Return on Assets (ROA) metric is determined by dividing the net

income of an entity by its total assets and is typically presented as a percentage. The metric denotes the degree to which a corporation is efficiently employing its resources to produce earnings (Sufian & Noor, 2012). The present study employs ROA as a dependent variable (Y variable) to evaluate the influence of ESG disclosure on the profitability of sharia commercial banks operating in Indonesia.

The Net Profit Margin (NPM) measures how much net income or profit is generated to evaluate a bank's performance. Current study using Net Profit Margin (NPM) instead of Net Interest Margin (NIM) because NPM considers all sources of income, not just interest income, which is important for a bank that operates based on Islamic principles. In Islamic banking, interest-based transactions are prohibited, and instead, banks generate income through profit-sharing arrangements with their customers (Hussain et al., 2015). Therefore, NPM is a more appropriate measure of a bank's profitability in this context. Additionally, studies have used NPM as one of the financial ratios to analyze the performance of Islamic banks. This variance is then compared to the total fee-earning assets. The Net Profit Margin (NPM) is a significant metric that gauges a bank's effectiveness in terms of handling its fee-generating assets and liabilities (Endri et al., 2020). The present study incorporates NPM as an additional dependent variable (Y variable) to offer a more comprehensive evaluation of the association between ESG disclosure and the profitability of sharia commercial banks.

The total asset is also considered as the control variable due to its potential impact on the profitability of banks (Athanasoglou et al., 2005). The term 'total assets' represents all the assets a company possesses, both tangible and intangible, at a specific time. Concrete assets comprise things like infrastructure and equipment, while intangible ones involve aspects like patents and trademarks. Evaluating the total assets of a company is crucial when determining its financial stability and profitability, and it's a vital aspect in numerous financial studies and assessments (Wahlen et al., 2017). In this study, we include total assets as a control variable because of their prominent role in influencing a firm's profitability. Prior research by Harisa et al. (2019) has suggested a significant relationship between a

company's total asset size and its profitability. Companies with larger total assets are often capable of producing more revenue due to their capability for extensive operations, dominant market presence, and the benefit of economies of scale. On the other hand, companies with lesser total assets might find it difficult to reach a similar level of profitability due to their restricted operational abilities.

In the context of Indonesian Sharia banking, total assets play a vital role in determining a bank's profitability. Research like the one conducted by Masood and Ashraf (2012) showed that total assets significantly affect the profitability of Islamic banks. Larger Islamic banks are usually more profitable, primarily because of their higher efficiency and advantages of scale. The use of total assets as a control variable ensures an accurate examination of the effect of ESG (Environmental, Social, and Governance) disclosure on profitability. By accounting for total assets, we can isolate the effect of ESG disclosure on profitability, thereby reducing the potential skewing effects that changes in total assets may cause.

The present study offers a comparative analysis of prior research that has examined the variables and proxies utilized in this investigation. The aforementioned factors encompass ESG reporting, financial performance metrics such as return on assets and Net Profit margin, environmentally conscious lending practices, corporate social responsibility investment vehicles, and deposit insurance premiums (DIP). Eccles et al. (2014) conducted a study to examine the correlation between financial performance metrics such as Return on Assets (ROA) and Net Profit Margin, and the disclosure of Environmental, Social, and Governance (ESG) factors. The research indicates that firms exhibiting robust environmental, social, and governance (ESG) performance tend to exhibit superior financial performance. Nevertheless, the present investigation did not concentrate explicitly on commercial banks operating under sharia principles.

The study conducted by Yin et al. (2021) investigated the factors influencing the adoption of green loan in China. The results of the study revealed a positive correlation between the level of green loan and the financial performance of banks. The present investigation offered valuable perspectives on the function of green

loan within the banking industry, albeit without a specific emphasis on sharia commercial banks or other Environmental, Social, and Governance (ESG) proxies. The study conducted by Yoestini et al. (2018) investigated the correlation between corporate social responsibility (CSR) funds and financial performance within the banking industry of Indonesia. A positive correlation was observed between funds allocated towards Corporate Social Responsibility (CSR) and profitability. Nonetheless, the study was centered on sharia banking institutions and did not take into account alternative ESG indicators or the particular circumstances of sharia financial institutions. The impact of deposit insurance premium on bank stability and performance was analyzed by Demirgüç-Kunt, et al. (2015). The authors arrived at the conclusion that deposit insurance systems that are well-designed have the potential to enhance financial stability. Nevertheless, the present study did not concentrate explicitly on the correlation between DIP and profitability, and neither did it take into account the sharia commercial banks' context or ESG disclosure.

The present study conducts an analysis of prior research that has examined the variables of Return on Assets (ROA), Net Profit Margin (NPM), and total assets. The ensuing discourse will entail an examination of the outcomes of said studies, with emphasis on the presence or absence of a favorable correlation. Sufian and Noor (2012) conducted a research study to examine the factors that influence bank performance in a developing economy. The study utilized the Return on Assets (ROA) metric as an indicator of profitability. The study revealed a positive correlation between bank-specific variables, such as capital adequacy and liquidity, and the return on assets (ROA). Nonetheless, the study was centered on the wider banking industry rather than exclusively on sharia commercial banks or the disclosure of environmental, social, and governance (ESG) factors). Athanasoglou et al. (2005) employed the Net Profit Margin (NPM) as a profitability metric in their investigation of the influence on bank profitability. The study's results indicated that there was a negative correlation between NPM and higher credit risk, whereas a positive correlation was observed between NPM and operational efficiency. Nonetheless, the research conducted did not place emphasis on sharia commercial banks or the disclosure of environmental, social, and governance (ESG) factors.

Harisa et al. (2019) conducted a study to examine the factors that influence the profitability of sharia banks. The study employed total assets as a control variable. The study revealed that there exists a positive correlation between the total assets and profitability of banks, with larger banks exhibiting higher levels of profitability. Nonetheless, the present study did not consider the impact of ESG disclosure on profitability. The aggregate value of a corporation's resources, comprising of cash, investments, property, and other assets, is referred to as total assets. Within the banking industry, the aggregate value of assets held by a financial institution is a significant metric that serves as a gauge of the institution's magnitude and economic capability. The inclusion of total assets as a control variable enables the investigation of the influence of ESG disclosure on profitability, while taking into consideration the variations in bank magnitude. The study incorporates total assets as a control variable to mitigate the potential confounding effect of bank size on the association between ESG disclosure and profitability.

However, implementing ESG in Sharia Banks is a relatively new concept that aims to align the Islamic values of Sharia Banks in Indonesia with the ESG aspects of sustainable finance. Challenges like the and how to integrate ESG disclosure to be part of a company's decision-making process to help to sustainable growth, lacking standardized and regulated ESG disclosure, the lacking awareness and demand of ESG product and service among sharia banks, to the potential trade-offs between profitability and sustainability, or the limited data of information on ESG performance and impact of sharia banks are met. Sharia banks may also find difficulties in attaining and verifying the data from their operations, products, and services, also lacking tools and expertise to analyze the data, which results in the various finding result regarding the impact of ESG disclosures on profitability from several previous studies mentioned before. Therefore, this study endeavors to achieve a comprehensive result of the profitability of sharia commercial banks through the utilization of these variables, with a focus on the impact of ESG disclosure. By employing ROA and NPM as the dependent variables (Y variables), to measure distinct dimensions of the profitability of sharia commercial banks operating in Indonesia. Also, the incorporation of total assets as a control variable,

which serves to mitigate the impact of variations in bank size and to safeguard against any potential influence of bank size on the association between ESG disclosure (as represented by green loan, CSR funds, and DIP) and profitability.

The study aims to offer insights into compliance of sharia commercial banking regulations and ESG in Indonesia. Additionally, it seeks to examine the influence of the country's environmental phenomena on ESG practices in the banking sector. By conducting the research, it can potentially contribute to several areas from the academic aspect to the practical aspect. From the academic aspect it can enhance knowledge on existing literature and provide empirical evidence about ESG disclosure and profitability in the Indonesian sharia banking sector, it may also encourage collaboration from interdisciplinary subject by gathering concepts and methodologies from the topics. From the practical aspect, this research can potentially contribute to company by serving valuable reference for sharia commercial banks in Indonesia, to investor by offering valuable insight about profitability of sharia commercial banks, and to government by utilizing the finding of this research to pay more attention toward ESG.

### **1.3 Problem Formulation**

ESG in Sharia Banks is a relatively new concept that integrates both principle, which creates challenges like the potential trade-offs between profitability and sustainability or the limited data on ESG performance and impact of sharia banks, and how to integrate ESG disclosure to be part of a company's decision-making process to help to sustainable growth. For there is a strong link between the banking industry and economic growth, when banks give additional funds to companies and individuals and offer more financial services, the economy hence grows.

From what has been said so far, a few questions have been brought up that are the basis for this theory. These things:

- 1) How does Green Loan significantly affect Return on Assets in the Sharia Banking Industry?

- 2) How does CSR Funds significantly affect Return on Assets in the Sharia Banking Industry?
- 3) How does Deposit Insurance Premium significantly affect Return on Assets in the Sharia Banking Industry?
- 4) How does Total Assets significantly affect Return on Assets in the Sharia Banking Industry?
- 5) How does Green Loan significantly affect Net Profit Margin in the Sharia Banking Industry?
- 6) How does CSR Funds significantly affect Net Profit Margin in the Sharia Banking Industry?
- 7) How does Deposit Insurance Premium significantly affect Net Profit Margin in the Sharia Banking Industry?
- 8) How does Total Assets significantly affect Net Profit Margin in the Sharia Banking Industry?
- 9) How do Green Loan, CSR Funds, Deposit Insurance Premium, Total Assets simultaneously affect Return on Assets in the Sharia Banking Industry?
- 10) How do Green Loan, CSR Funds, Deposit Insurance Premium, Total Assets simultaneously affect Net Profit Margin in the Sharia Banking Industry?

#### **1.4 Research Purposes**

In line with the research topic the following research purposes can be established:

- 1) To find out how Green Loan affects Return on Assets in the Sharia Banking Industry.
- 2) To find out how CSR Funds affect Return on Assets in the Sharia Banking Industry.
- 3) To find out how Deposit Insurance Premium affects Return on Assets in the Sharia Banking Industry.
- 4) To find out how Total Assets affect Return on Assets in the Sharia Banking Industry.
- 5) To find out how Green Loan affects Net Profit Margin in the Sharia Banking Industry.



- 6) To find out how CSR Funds affect Net Profit Margin in the Sharia Banking Industry.
- 7) To find out how Deposit Insurance Premium affects Net Profit Margin in the Sharia Banking Industry.
- 8) To find out how Total Assets affect Net Profit Margin in the Sharia Banking Industry.
- 9) To find out how Green Loan, CSR Funds, Deposit Insurance Premium, Total Assets simultaneously affect Return on Assets in the Sharia Banking Industry.
- 10) To find out how Green Loan, CSR Funds, Deposit Insurance Premium, Total Assets simultaneously affect NPM in the Sharia Banking Industry.

## **1.5 Research Benefits**

### **1.5.1 Academic Aspects**

The academic benefits of conducting this encompass advancing knowledge on ESG practices and their impact on profitability in sharia commercial banks, thus contributing to the existing literature on sustainable finance, corporate social responsibility, and sharia financial institutions' performance. This research provides empirical evidence on the relationship between ESG disclosure and profitability in the Indonesian sharia banking sector, offering insights into the moderating effects of bank size and other control variables, and enhancing the understanding of the individual and combined effects of various ESG proxies on profitability. The findings can inform the development of academic programs and courses related to sustainable finance, sharia banking, and corporate social responsibility, as well as policy recommendations and regulatory initiatives aimed at promoting ESG practices and enhancing the performance of sharia commercial banks in Indonesia. Furthermore, this research encourages interdisciplinary collaboration by bringing together concepts and methodologies from finance, economics, sustainability, and sharia studies, fostering knowledge exchange among scholars from diverse academic backgrounds also for further research reference.

### **1.5.2 Practical Aspects**

- 1) For company, the findings of this research can serve as a valuable reference for sharia commercial banks in Indonesia, helping them better understand the importance of ESG disclosure and its potential impact on profitability. By identifying the most influential ESG proxies and assessing the moderating effects of bank size and other control variables, banks can develop more effective strategies to improve their ESG practices and, in turn, enhance their financial performance.
- 2) For investors, by investigating the impact of ESG disclosure on the profitability of sharia commercial banks, this research offers valuable insights for investors seeking to make informed decisions about their investments in the sector. Understanding the relationship between ESG practices and financial performance can help investors identify banks that are more likely to generate higher returns while adhering to sustainable principles.
- 3) For government, the government can utilize the findings of this study to encourage Indonesian sharia banks to focus more on ESG principles, given their potential influence on profitability. This could manifest in the form of implementing policies that incentivize sharia banks to improve their ESG disclosures or to align their operations more closely with ESG principles. Such actions could not only improve the profitability and stability of the banks themselves, but also contribute to achieving broader social, environmental, and governance objectives of the government.

### **1.6 Systematics of Final Project Writing**

Contains systematics and a brief explanation of research reports consisting of Chapters I to V in research reports.

#### **a. CHAPTER I INTRODUCTION**

This section is a general, concise, and short description that accurately describes the content of the study. The contents of this chapter include Overview of research objects, Research Background, Problem Formulation, Research Objectives, Research Benefits, and Systematics of Final Project Writing.

**b. CHAPTER II LITERATURE REVIEW**

This chapter contains theories from general to specific, accompanied by previous research and is followed by a research framework that ends with a hypothesis if necessary.

**c. CHAPTER III RESEARCH METHOD**

This chapter outlines the approaches, methods and techniques used to collect and analyze findings that address research problems. This chapter includes descriptions of: Types of Research, Operationalization of Variables, Population and Samples (for quantitative) or Social Situations (for qualitative), Data Collection, Validity and Reliability Tests, and Data Analysis Techniques.

**d. CHAPTER IV RESULTS AND DISCUSSION**

The findings of the study and discussions are given systematically in accordance with the formulation of the problem and research objectives and are presented in separate subtitles. This chapter contains two parts: the first part presents the research results, and the second part presents a discussion or analysis of the research results. Every aspect of the discussion should begin with the results of data analysis, then interpret it and then follow it by drawing conclusions. In the discussion, it should be compared with previous studies or relevant theoretical foundations.

**e. CHAPTER V CONCLUSIONS AND SUGGESTIONS**

The conclusion is the answer to the research question, then becomes a suggestion related to the benefits of the research.