

The Influence of Environmental, Social, and Governance (ESG) on Financial Distress

(Empirical Study of Banking Sector Companies Listed on the IDX for the Period 2021–2024)

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ABSTRACT

Financial distress is a condition of financial difficulty experienced by a company before bankruptcy, which can be influenced by the implementation of Environmental, Social, and Governance (ESG). ESG serves as an important indicator in assessing a company's sustainability and responsibility toward the environment, society, and governance. This study aims to determine the influence of environmental, social, and governance on financial distress in banking sector companies listed on the Indonesia Stock Exchange (IDX) for the 2021–2024 period. Financial distress in this study is measured using the Z-Score, where a higher Z-Score indicates more stable financial conditions and a lower risk of financial distress. Secondary data were obtained from company annual reports and ESG data sourced from Bloomberg. The population encompasses all banking sector companies listed on the IDX. Using purposive sampling, 19 companies were selected with a total of 76 observations. Panel data regression analysis was conducted using EViews 13 software. The results show that environmental does not significantly affect financial distress, meaning that environmental performance has not yet become a determining factor in explaining the financial stability of banking companies during the study period. Social also does not significantly affect financial distress, indicating that social responsibility practices have not directly influenced banks' financial distress conditions. Governance has a significant effect on financial distress, meaning that stronger corporate governance contributes to better financial stability and reduces the possibility of financial distress. Meanwhile, ESG Score does not significantly affect financial distress, indicating that the overall ESG performance has not been strong enough to explain variations in financial distress among banking companies.

Keywords: Environmental, Social, Governance (ESG); Financial Distress; Z-Score; Banking Sector

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Introduction

Discussion of *Environmental, Social, and Governance* (ESG) in Indonesia is moving quite rapidly, although the direction of its practice has not yet fully stabilized. Regulations are pushing, the market is beginning to demand, but the readiness of each bank is not identical. According to the Financial Services Authority (OJK), most commercial banks have compiled sustainability reports as part of implementing sustainable finance, with an adoption rate exceeding 80% (OJK, 2023). However, this figure more reflects administrative compliance than integration of ESG into strategic decisions.

The banking sector plays an important role in maintaining the stability and growth of a country's economy. As financial intermediation institutions, banks collect and channel funds to the public, making banking performance a primary factor in supporting national economic activity. However, in recent years, the banking industry has faced various challenges due to global economic uncertainty, regulatory changes, technological developments, and the impact of the COVID-19 pandemic since 2020. These conditions have increased the risk of *financial distress* in banking companies (Nurhuda & Safi'i, 2023).

Financial distress is a condition of declining corporate financial performance characterized by the company's inability to meet its financial obligations, thus affecting the continuity of corporate operations. Cases such as the collapse of Silicon Valley Bank (SVB) in the United States in 2023 due to liquidity crises and weak risk management, as well as Credit Suisse's acquisition by UBS in 2023, highlight the vulnerability of the banking sector to financial distress (Nurhuda & Safi'i, 2023).

ESG consists of three main aspects *Environmental*, *Social*, and *Governance* each with different implications for financial risk. According to (Husada & Handayani, 2021), ESG can be defined as a medium to evaluate the progress and sustainability of a company based on the management of environmental, social, and governance factors. The application of ESG is considered capable of increasing transparency, reducing corporate risk, and creating long-term business sustainability.

Empirical research shows inconsistent results. (Lins et al., 2017) found that companies with good ESG performance have greater resilience during crises, while (Albuquerque et al., 2019) showed that ESG can reduce systematic risk. However, (Tarihoran et al., 2025) found that ESG disclosure does not always significantly affect performance, and (Xaviera & Rahman, 2023) showed that the relationship varies by sector. This inconsistency highlights the need for further research, particularly in the Indonesian banking sector during the 2021–2024 period.

THEORITICAL FOUNDATION AND HYPOTHESIS DEVELOPMENT

Stakeholder Theory

Stakeholder theory was first introduced by R. Edward Freeman in 1984 through his book *Strategic Management: A Stakeholder Approach*. This theory explains that companies are not only responsible to shareholders, but also to all parties who have an interest in the company's activities (stakeholders), such as investors, creditors, employees, customers, government, community, and the surrounding environment (Iznillah et al., 2024).

In the context of ESG, stakeholder theory explains that the application of environmental, social, and governance aspects can help companies improve their relationships with stakeholders, increase corporate transparency, and maintain corporate reputation. Companies with good ESG implementation tend to gain a higher level of trust from both investors and the public.

Environmental

Environmental is one of the components in the concept of ESG that relates to the company's responsibility towards the natural environment. According to (Minggu et al., 2023), the environmental aspect in a company is an important part of supporting business sustainability. Companies that optimally implement the environmental aspect tend to have a better reputation in the eyes of investors and society (Minggu et al., 2023).

In this study, the environmental aspect is measured using the environmental score obtained from Bloomberg. The higher the environmental score, the better the company's environmental responsibility implementation.

Social

Social is one of the components in ESG that relates to the company's responsibility to society and stakeholders. The social aspect describes how a company builds good relationships with employees, customers, communities, and other parties involved in company activities (Riani et al., 2024).

In this study, the social aspect is measured using the Social Score obtained from Bloomberg. The higher the social score, the better the company's social responsibility implementation.

Governance

Governance is one of the components in ESG that relates to the company's governance system in running company operations. The governance aspect reflects how the company is managed transparently, accountably, responsibly, independently, and fairly (Riani et al., 2024).

In this study, governance is measured using the Governance Score from Bloomberg. Companies with higher governance scores are expected to improve transparency and reduce financial risk so as to minimize potential financial distress.

Financial Distress

Financial distress is a condition where a company experiences financial difficulties characterized by the inability to meet its financial obligations. (Nurhuda & Safi'i, 2023) state that financial distress occurs when a company's cash flow is insufficient to meet its financial obligations, thereby increasing the risk of default.

In this study, financial distress is measured using the Z-score formula as follows: $Z\text{-Score} = [\text{ROA} + (\text{Equity}/\text{Total Assets})] / \sigma\text{ROA}$, where ROA = Return on Assets and σROA = standard deviation of ROA. A higher Z-score indicates more stable financial conditions and lower financial distress risk (Lestari et al., 2024).

Framework and Hypotheses

This study employs a framework comprising the following research variables:

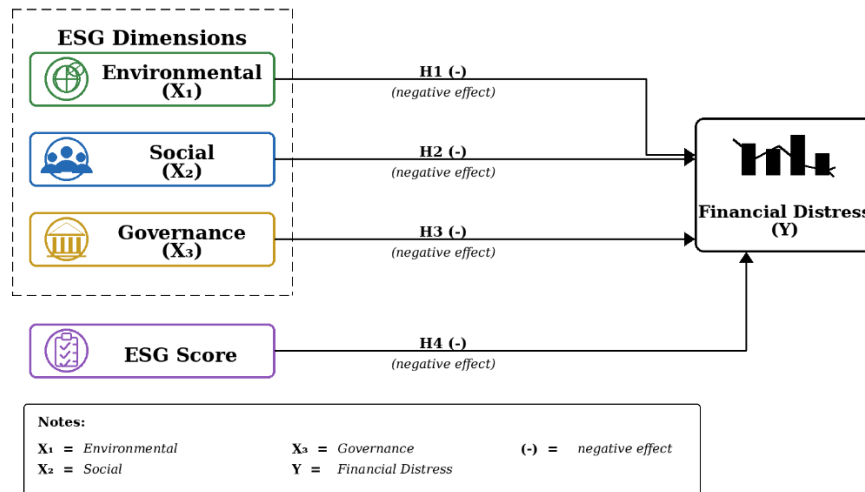


Figure 1. Conceptual Framework

Notes:

H1 = Environmental has a negative and significant effect on financial distress

H2 = Social has a negative and significant effect on financial distress

H3 = Governance has a negative and significant effect on financial distress

H4 = ESG Score has a negative and significant effect on financial distress

RESEARCH METHODOLOGY

Type of Research and Data Sources

This study employs a systematic quantitative research method. The data is secondary in nature, obtained from company annual reports routinely submitted to the official website of the Indonesia Stock Exchange (IDX), as well as ESG data obtained from Bloomberg.

Population and Sample

The population in this study consists of banking sector companies listed on the Indonesia Stock Exchange (IDX) during the 2021–2024 period, totaling 43 companies. Sampling was conducted using purposive sampling with the following criteria: consistently listed on the IDX during 2021–2024; having complete ESG Score data (Environmental, Social, Governance) available on Bloomberg; publishing complete Annual Reports during 2021–2024; and using Indonesian Rupiah as the reporting currency. Based on these criteria, 19 companies were selected, resulting in 76 total observations.

Data Analysis Techniques

Data processing in this study was performed using EViews 13 software. Data analysis was performed using descriptive statistics, classical assumption tests (multicollinearity and heteroscedasticity), model selection tests (Chow Test, Hausman Test, Lagrange Multiplier Test), and hypothesis testing using panel data regression analysis. Data analysis used panel data regression with EViews 13 software.

RESULTS AND DISCUSSION

Model Selection Test

Based on the Chow Test, the probability value of Cross-section F was $0.0000 < 0.05$, so Fixed Effect Model (FEM) is preferred over Common Effect Model (CEM). The Hausman Test yielded a Chi-Square probability of $0.8900 > 0.05$, so Random Effect Model (REM) is preferred. The Lagrange Multiplier Test confirmed REM with a Breusch-Pagan probability of $0.0000 < 0.05$. Therefore, Random Effect Model (REM) is used as the best estimation model.

Descriptive Analysis

Descriptive statistical analysis was conducted to calculate the mean, minimum, maximum, and standard deviation of the data. In this study, four variables were analyzed: environmental, social, governance, and financial distress. The results of this descriptive statistical analysis were processed using EViews 13, as shown in the following table:

Table 1. Results of Descriptive Statistics Test

Variable	Statistic Descriptive				
	N	Mean	Minimum	Maximum	Std. Deviation
<i>Environmental (X1)</i>	76	23.3901	0.8500	47.6000	12.2371
<i>Social (X2)</i>	76	40.9161	16.6900	58.0100	10.9963
<i>Governance (X3)</i>	76	86.2725	68.5700	97.5000	8.3428
<i>Financial Distress (Y)</i>	76	102.5633	-0.4927	1081.037	222.0844

Source: EViews output, processed 2026

Environmental (X1) has a mean of 23.39, indicating that the average level of environmental disclosure among sampled banking companies is in the moderate range. The minimum value of 0.85 was recorded by PT Allo Bank Indonesia Tbk in 2021, while the maximum of 47.60 belonged to PT Bank Tabungan Negara Tbk in 2022. The standard deviation of 12.24 reflects considerable variation in environmental performance across companies and periods. *Social (X2)* has a mean of 40.92. The minimum value of 16.69 was held by PT Allo Bank Indonesia Tbk in 2021, and the maximum of 58.01 by PT Bank CIMB Niaga Tbk in 2021. The standard deviation of 10.996 shows notable variation in social disclosure across the sample.

Governance (X3) has a mean of 86.27, indicating relatively high governance scores among sampled companies. The minimum of 68.57 was from PT Bank Mega Tbk in 2021, and the maximum of 97.50 from PT Bank CIMB Niaga Tbk in 2021. The smaller standard deviation of 8.34 suggests more homogeneous governance practices. *Financial Distress (Y)* measured by Z-Score has a mean of 102.56. The minimum of -0.4927 was from PT Bank Raya Indonesia Tbk in 2021, while the maximum of 1,081.04 belonged to PT Bank Mayapada Internasional Tbk in 2021. The very high standard deviation of 222.08 reflects large dispersion and heterogeneity in financial distress conditions across the sample.

Test of Classical Assumptions

Multicollinearity Test

Table 2. Result of the Multicollinearity Test

Multicollinearity Test			
Variable	ENV (X1)	SOC (X2)	GOV (X3)
ENV (X1)	1.000000	0.640317	0.395716
SOC (X2)	0.640317	1.000000	0.443716
GOV (X3)	0.395716	0.443716	1.000000

Source: EViews output, processed 2026

The multicollinearity test results above show that all correlation coefficients between variables are below 0.85. Therefore, it can be concluded that the data is free from multicollinearity.

Heteroskedastisitas Test

Table 3. Heteroscedasticity Test Results

Heteroscedasticity Test				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	68.8272	240.0769	0.2867	0.7752
X1 (ENV)	-1.0839	2.4268	-0.4466	0.6565
X2 (SOC)	-3.1673	2.7675	-1.1444	0.2562
X3 (GOV)	2.2145	3.0509	0.7259	0.4703

Source: EViews output, processed 2026

All probability values for X1 (0.6565), X2 (0.2562), and X3 (0.4703) are greater than $\alpha = 0.05$, confirming no heteroscedasticity problem. Residual variance is constant (homoscedastic), and regression results are valid for further analysis.

Panel Data Regression Analysis

1. t-Test (Partial)

Table 4. t-Test: Influence of Environmental, Social, Governance on Financial Distress (Model 1)

Panel Least Square				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	42.5831	75.4223	0.5646	0.5741
X1 (ENV)	0.1218	0.6572	0.1854	0.8534
X2 (SOC)	-0.6463	0.6090	-1.0612	0.2922
X3 (GOV)	0.9687	0.4796	2.0198	0.0471

Source: EViews 13 output, processed 2026

The t-test results for Environmental (X1) yielded a probability value of $0.8534 > 0.05$, therefore Environmental (X1) is not significant with respect to Financial Distress (Y). The t-test results for Social (X2) yielded a probability value of $0.2922 > 0.05$, therefore Social (X2) is not significant with respect to Financial Distress (Y). The t-test results for Governance (X3) yielded a probability value of $0.0471 < 0.05$, therefore Governance (X3) is significant with respect to Financial Distress (Y).

Table 5. Partial t-Test: Influence of ESG Score on Financial Distress (Model 2)

Panel Least Square				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	152.5184	63.5413	2.4003	0.0189
ESG Score	-1.0029	0.7166	-1.3995	0.1659

Source: EViews output, processed 2026

The t-test results for ESG Score yielded a probability value of $0.1659 > 0.05$, therefore ESG Score is not significant with respect to Financial Distress (Y).

Coefficient of Determination

Table 6. Coefficient of Determination (R²)

Panel Least Square		
Indicator	Model 1 (ENV, SOC, GOV)	Model 2 (ESG Score)
Regression Equation	$Y = 42.583 + 0.122X1 - 0.646X2 + 0.969X3 + e$	$Y = 152.518 - 1.003 \text{ ESG_SCORE} + e$
R-squared	0.0957	0.0260
Adjusted R-squared	0.0580 (5.80%)	0.0128 (1.28%)
F-statistic	2.5399	1.9768
Prob(F-statistic)	0.0631 (Not Significant)	0.1639 (Not Significant)

Source: EViews output, processed 2026

Model 1 (Environmental, Social, Governance separately) has an R-squared of 0.0957, meaning these variables explain 9.57% of the variation in Financial Distress. Model 2 (ESG Score) has an R-squared of 0.0260, explaining 2.60% of variation.

Discussion Of Research Findings

1. The Effect of Environmental on Financial Distress

This study demonstrates that Environmental does not have a significant effect on Financial Distress (prob. 0.8534 > 0.05). This result indicates that the disclosure and implementation of environmental aspects by banking companies has not yet been able to provide a direct impact on the company's financial distress condition. This is consistent with research by (Gharchia & Mindosa, 2023), which found that environmental does not significantly affect financial distress, explaining that the benefits of environmental aspects tend to be long-term and have not yet been able to directly affect financial distress.

2. The Effect of Social on Financial Distress

The results of this study indicate that Social does not have a significant effect on Financial Distress (prob. 0.2922 > 0.05). Although the negative direction of the coefficient indicates that increased social performance tends to reduce financial distress risk, this effect is not statistically strong enough. This aligns with findings by (Sari et al., 2025), who found that companies experiencing financial difficulties tend to reduce their social activities.

3. The Effect of Governance on Financial Distress

In this study, Governance was found to have a significant positive effect on Financial Distress (prob. 0.0471 < 0.05). The positive coefficient indicates that companies facing financial distress tend to increase their governance practices to strengthen transparency and accountability before stakeholders. This is consistent with research by (Khairunnisa & Setiawati, 2025), which shows that governance disclosure has a significant effect on financial distress.

4. The Effect of ESG Score on Financial Distress

The test results indicate that ESG Score does not have a significant effect on Financial Distress (prob. 0.1659 > 0.05). Although the negative coefficient indicates that higher ESG Score tends to reduce financial distress, this effect could not be proven statistically. This aligns with research by (Afriana & Afriyenti, 2026), which found that ESG does not significantly affect financial distress statistically.

Conclusion

This study examines the influence of Environmental, Social, and Governance (ESG) on financial distress in banking sector companies listed on the Indonesia Stock Exchange during the study period, using panel data regression with the Random Effect Model. Based on the results, Environmental does not significantly affect financial distress. This indicates that environmental performance has not become a direct factor in determining the financial distress condition of banking companies. The benefits of environmental practices tend to appear in the long term through improved reputation, resource efficiency, and better environmental risk management, rather than being directly reflected in short-term financial stability.

Social also does not significantly affect financial distress. This finding indicates that social performance has not directly influenced the financial distress condition of banking companies. Social activities are more closely related to improving corporate image, stakeholder relationships, customer trust, and social responsibility, but these benefits may not immediately affect the company's financial condition.

Governance has a significant effect on financial distress, although the direction of the relationship differs from the initial expectation. This finding indicates that governance plays an important role in financial distress conditions. Companies facing financial pressure may strengthen governance practices and disclosures as an effort to improve credibility, transparency, and stakeholder confidence. Therefore, governance becomes an important aspect in maintaining corporate accountability and financial resilience.

Meanwhile, the overall ESG Score does not significantly affect financial distress. This shows that ESG implementation as a whole has not been strong enough to explain financial distress conditions in the banking sector. Financial distress in banking companies is likely influenced more by fundamental financial factors, such as profitability, leverage, liquidity, asset quality, and macroeconomic conditions. Future research is recommended to expand the research period, increase the number of sample companies, examine other sectors, and include additional financial variables such as NPL, CAR, NIM, leverage, liquidity, and macroeconomic indicators to obtain a more comprehensive research model.

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