CHAPTER I
INTRODUCTION

1.1 Background

The business environment today has experienced many changes. The change is due to globalization, unlimited technological developments in society, and the business environment changing continuously. These changes make companies have to adapt quickly and accurately to compete in an increasingly tight industry. Changes in the business environment also create new risks that companies can face to survive in business competition.

In the future, the business environment will always face uncertainty. Uncertainty can represent a risk or an opportunity that affects the company's objectives. The company has a responsibility to improve the welfare of its stakeholders, one of which is to improve the company's performance so that it can provide returns to stakeholders. Therefore, the company will try to manage its uncertainty to give returns to its stakeholders.

In December 2019, the world was shocked by an incident, namely the emergence of a pneumonia case in Wuhan City, China, and identifying this pneumonia as a new variant of the coronavirus (Yamali & Putri, 2020). After some time, several countries reported similar cases. In response to this phenomenon, WHO announced the mutation of the new virus, the name COVID-19 on 11 February 2020. The Covid-19 virus continues to spread to other regions of the world, including in Southeast Asia. Thailand was the first country to confirm its first positive case of Covid-19 on 13 January 2020, followed by Singapore, Vietnam, Malaysia, and the Philippines, respectively, in the same month. Indonesia confirmed its first case on 2 March 2020. The last two countries to document cases of Covid-19 were Laos and Myanmar on 24 March 2020 (Jaya, et al., 2020).

The high-speed rate of spread and transmission caused the government to impose a lockdown policy, resulting in an economic contraction throughout the world, including ASEAN. Indonesia experienced a contraction of 5.3 percent, the deepest since the 1997-1998 financial crisis. Singapore and Thailand experienced a contraction of minus 6 percent and 6.6 percent, respectively. The same thing happened in Malaysia: a contraction of minus 5.8 percent. The Philippines experienced the most severe contraction, 9.6 percent (Akbar & Silaban, 2021). Even though the economy has experienced a decline due to this pandemic, the banking sector in ASEAN is still in good condition, even helping regulators overcome problems in this economic downturn. In developed countries, companies have efficient access to the corporate credit market, so they can easily raise funds. Even companies with weak financial conditions can still get affordable interest rates amid low interest rates, as investors remain attracted to the yields on offer. However, in ASEAN, the corporate credit market is still in its infancy, and regional banks remain the main source of loans. About 80-100% of corporations in Indonesia, the Philippines and Vietnam come from loan banking. Although Singapore, Malaysia and Thailand have more developed debt markets, bank loans remain the dominant source of financing in these countries. Therefore, the performance of banks and the risks they face have a direct impact on the credit cycle and the economy as a whole. Bank performance also influences the stock market, especially in Singapore and Indonesia, where banks are the main component of the stock index. About 40% of the Straits Times Index and Jakarta Stock Exchange Jakarta Composite Index are linked to banks. From a macroeconomic perspective, banks are also the main channel for monetary policy transmission. Since the Asian Financial Crisis in 1997, ASEAN banks have increased their capital and implemented more disciplined risk management (Zurich Insurance Company Ltd, 2021). With this role, the bank has become an institution that also influences the economic development of a country (Attar et al., 2014).

Banking Sector Financial Metrics by Country					
Capital Adequacy	**ASEAN**	**India**	**US**	**Germany**	**China**
CAR (Capital to Asset Ratio) %	11,1	8,0	11,8	6,3	9,3
Asset Quality					
NPL to Gross Loans (%)	1,8	9,2	0,9	1,1	1,9
Profitability					
Net Interest Margin (%)	3,5	3,0	3,5	1,2	2,3
Return on Equity (%)	14,5	9,1	13,6	5,0	16,7
Valuation	**ASEAN**	**India**	**US**	**Europe**	**China**
12m forward P/E	12,0	16,0	13,4	11,5	6,8
12m forward P/B	1,1	2	1,3	0,6	0,8

Favourable — Less Favourable

Table 1 Financial Metrics in ASEAN Banking Sector

Source: Latest data available from the World Bank (2019 and 2017), Bloomberg, ZIG

(Zurich Insurance Company Ltd, 2021)

The matrix above shows that ASEAN banks are in good condition. Even the Capital to Asset Ratio has an average of 11%, almost the same as banks in the US and bigger than banks in Europe. Banking in ASEAN also helps the government because it is encouraged to buy government bonds which are sold to foreign investors. For example, banks in Indonesia currently hold about half of total government bonds, up from only 20% in the previous year. This poses a greater sovereign risk to banks, while increasing bank risks to governments. Despite the risks inherent in the relationship between banks and governments, ASEAN has an advantage over the European Union (EU). Each country in ASEAN has an independent monetary and currency policy. Moreover, central banks in the region have gained credibility in ensuring financial stability over the past few years. Thus, the risk of debt default of ASEAN countries tends to be relatively small (Zurich Insurance Company Ltd, 2021). This is why the banking sector is interesting to be the subject of this study.

The banking sector realizes every risk can affect firm performance. The amount of funds collected and managed by the bank is not small, which causes the risks faced to be very large (Yanti & Setiyanto, 2021). One of the ways used by banks in ASEAN to deal with the Covid-19 crisis is by implementing Enterprise Risk Management (ERM). The Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines ERM as a process that is affected by an entity's board of directors, management, and other personnel, applied in the formulation and determination of strategy within the company, designed to identify events that potentially affect the entity, and manage risk to match the risk appetite, to assure the achievement of the entity's objectives (COSO, 2004). Implementing ERM assists companies in identifying potential impacts on the company and manages risks and possible risks that can have impact to company goals. Deloitte surveyed to assess the adoption of practices in the global financial services industry. As a result, 84% of financial companies that took part in the survey said that they had implemented an ERM program in their companies. As many as 75% of respondents stated that risk management in their institution was considered very practical or effective overall when asked to rate it (Deloitte, 2021).

In March 2023, Silicon Valley Bank (SVB), a supplier of funds for start-ups in Silicon, experienced sudden bankruptcy within 48 hours. This was due to mass withdrawals which caused SVB to fail to pay. According to the New York Times, SVB's bankruptcy was caused by management's own mistakes because the CEO of SVB was too much to innovate for the future and did not pay attention to the usual but critical work, namely managing risk and ensuring financial security (Farrell, 2023). In the same week, the government closed a New York-based bank, Signature Bank. This happens due to instability in the stable coins market (CNBC Indonesia, 2023). The implementation of ERM in America and Canada is more universal compared to Europe, let alone Asia Pacific (Deloitte, 2019). This illustrates that even countries that have universally implemented ERM in various sectors can still experience failure in dealing with risks. The application of ERM in Asia Pacific is still relatively early compared to Europe and America. However, the application of ERM in the Asia Pacific, especially Southeast Asia, has increased.

The ASEAN region has varied markets, economic development, and culture, making it one of the most competitive regions in the world today. This diversity offers diverse investment opportunities and expands possibilities (ASEAN, 2023). ASEAN consist of 10 countries in the Southeast Asia region. Indonesia, Malaysia, Singapore, Thailand, and the Philippines is known as the ASEAN 5 because they are the five largest countries in ASEAN. Furthermore, these countries have similarities in their geographical location and social contexts (Chairani & Siregar, 2021b). Based on the World Bank, Indonesia has the largest economy in ASEAN, with the gross domestic product (GDP) reaching US$1.19 quadrillion in 2021. Based on a survey conducted by US News in 2022, Malaysia and Singapore are in the top 15 destination countries for companies to expand their business. In the same study, Singapore is also included in the top 5 countries to invest in (US News, 2022). In 2021, Singapore also received the highest inward FDI in ASEAN, with an FDI value of US$99.1 billion, equivalent to half of the total inward FDI in ASEAN (ASEAN Secretariat, 2022). Another ASEAN countries, Thailand, is on the top ten lists of fastest-growing economies in the world, above Japan (US News, 2022). Although Philippines infrastructure is the worst among the ASEAN 5, they have steadily risen in global competitiveness from 87th to 47th in 2016, according to data from 2009 to 2017. This is one reason why the Philippines is called the “next Asian tiger” (Diokno, Benjamin, 2017). The huge potential possessed by ASEAN 5 makes it very important to implement ERM practices to support the sustainability of companies in these five countries, especially in the banking sector.

Applying ERM is increasingly needed by banking companies worldwide to overcome risks that can be faced amid increasingly fierce competition, especially ASEAN 5 countries. However, several phenomena are still related to applying risk management in the banking sector. Jiwasraya, an insurance company owned by the Indonesian government, experienced a default case in 2019 due to an investment management error, namely investing in underperforming stocks (Ulya, 2020). This case is one of the largest corruption cases in Indonesia, with losses reaching 16.8 trillion rupiah (Sandria, 2022).

In Malaysia, the 1MDB money laundering and embezzlement case in 2015 was a shocking scandal in the financial world. 1MDB, or 1Malaysia Development Bhd, is a government company engaged in investment. More than 4 billion USD were stolen and used for a luxurious life, such as buying art and cruises, to finance a film. This case involved the Prime Minister of Malaysia, Najib Razak, and Goldman Sachs bankers, who also assisted in this money laundering action (BBC, 2022). This case also involved a bank in Singapore, BSI Bank Limited, for embezzlement of funds by employees at the bank. The 1MDB case was one of the reasons Singapore's central bank, the Monetary Authority of Singapore (MAS), ordered BSI Bank Limited to close its office in Singapore in 2016. Other reasons for the closure of BSI Bank include violations of anti-money laundering regulations and poor management supervision of bank operations (JX, 2017). In 2021, online banking fraud affected 40,000 people in Thailand. This is because there are unauthorized online transactions by scammers that misused around 10,700 cards. According to Bank Of Thailand, the total lost is around 130 million baht ($3.9 Million) (Li, 2021). In addition, credit card fraud increased by 21% since the start of the coronavirus pandemic, according to the Credit Card Association of the Philippines (CCAP). Cybercriminals are getting more creative with exploiting their victims, as more Filipinos are shifting to cashless methods of payment (Alegado, 2022)

This phenomenon has made ERM the main focus in financial sector, in particular banking. The five countries also have regulations regarding implementing ERM in the banking sector. Indonesia already has several regulations related to ERM issued by the Financial Services Authority, namely OJK regulation number 18/POJK.03/2016 concerning the Implementation of Risk Management for Commercial Banks, which states that banks are required to implement risk management effectively (Otoritas Jasa Keuangan, 2016). In Malaysia, a framework is set out in the Malaysian Code on Corporate Governance (MCCG) and regulations related to risk management disclosure in the financial sector issued by Bank Negara Malaysia (Ali et al., 2019). MAS released a Guideline on Risk Management for Singapore's financial sector, which contains guidelines for managing the financial sector's risks. Thailand also released Guidelines For Risk Management Practices for the financial sector in 2005 and Guideline on Liquidity Risk Management of Financial Institutions, in line with Basel Committee Banking Supervision in 2010 (Bank of Thailand, n.d.). Furthermore, Philippines Stock Exchange also launched Enterprise Risk Management Framework in 2022.

From several existing phenomena, it can be said that there are weaknesses in ERM in the banks of the five countries. Scandals involving embezzlement of money, inappropriate investment decisions, and lack of management oversight of bank operations can harm the banking performance. The scandal could affect public and investor confidence in the financial industry, especially banking, in the five countries and can affect the firm value. Thus, the application of ERM in banking companies influences their firm value. Chairani and Siregar conducted a study on the effect of erm on firm performance in ASEAN 5 countries. It was found that ERM has a significant role in firm performance (Chairani & Siregar, 2021a). This is also in accordance with various studies that have been conducted in Germany, England, France, Italia, America, and Ghana (Callahan & Soileau, 2017; Florio & Leoni, 2017; Ghazieh & Chebana, 2021; Horvey & Ankamah, 2020).

However, several studies say that the application of ERM has a negative relationship with changes in the company's financial performance.

According to Otero Gonzalez, the implementation of ERM in Spanish companies is not related to changes in financial performance (Otero González et al., 2020). Similar results were also found by Alawattegama who conducted research in the Sri Lankan banking and financial industry and found that ERM did not significantly affect firm performance (Alawattegama, 2017). Then, a study conducted by Lin also found that implementing ERM had a significant and negative impact on firm performance (Lin et al., 2011).

Besides ERM, other factors can affect financial performance in the financial industry, especially banking. They have extensive experience managing financial risks, such as market, credit, and liquidity. But in recent years, companies have increased their attention to non-financial risks, which significantly impact companies but are more challenging to measure. Based on a survey conducted by Deloitte of companies in the financial industry in 2020, Environmental, Social, and Governance (ESG) risks rank first in the types of risks that will increase the interests of their institutions, with a total vote of 38% (Deloitte, 2021). ESG is used to implement sustainability practices in running a business that considers three aspects, Environment, Social, and Governance, to assess company performance, share value, and risk profile in addition to using a financial perspective. ESG has become essential to financial institutions over the years due to the increasing pressure on them to demonstrate their commitment to a sustainable business (Roland Berger, 2022).

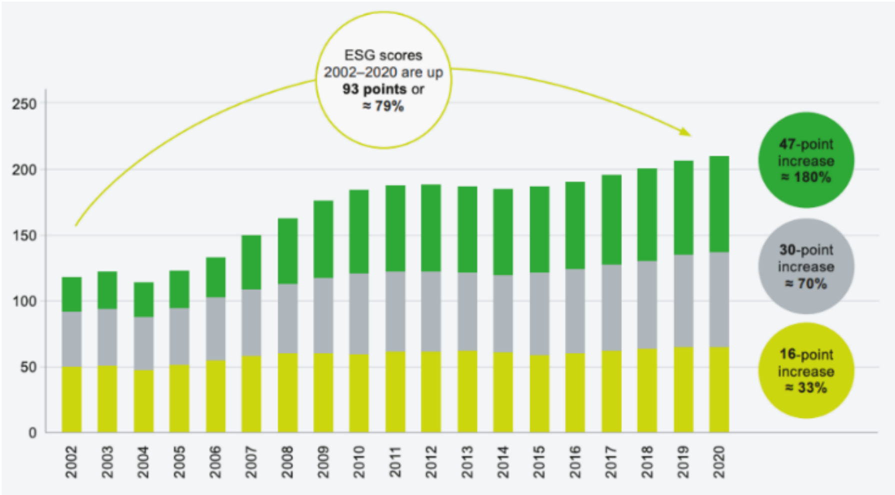

Figure 1 Graph of ESG Scores from 2002 to 2020

(Roland Berger, 2022)

Based on the graph above, there was an increase of 79% in ESG scores in the European banking industry from 2002 to 2020. This means that ESG is a trend growing significantly in the banking sector. There are several reasons why ESG is essential in today's banking industry. One of the reasons, there is encouragement from consumers to implement ESG practices for banking. A survey conducted by Kearney found that 15 percent of consumer banks in the United States switched from their primary bank for various reasons, and 65 percent said they tended to switch to banks based on environmental and social activities, with ESG-related actions ranking (Nagarsheth, Arcati, & Desentis, 2022). The survey is also in line with that conducted by PwC that 83% of consumers believe companies must be active in carrying out ESG practices. 76% of consumers say they would cut ties with a company that treats employees, communities, and the environment badly (PwC, 2021). Not only consumers, banks have also considered ESG factors in making decisions. Research by Houston and Shan found that the bank has considered the credit decision based on the main profile of the creditor (Houston & Shan, 2021).

In addition, today's investors realize how important ESG is in financial matters and investment decisions. So, they asked the bank to show

how it integrates ESG into its lending mechanism and risk framework and drives real results and impact while getting a return on its investment (B&FT Online, 2022). According to research conducted by BlackRock, one in 5 investors is more interested in sustainable investing due to the pandemic and intends to spend more on sustainable investment that has an impact for the next five years. (Hampson, 2021). PwC also found similar results in 2021, where 79% of investors believed that the company's ESG performance was one of the bases for making investment decisions. Furthermore, ESG can also improve company finances. According to Kearney, a bank that treats its social and environmental aspects well will also strengthen its finances. Kearney estimates that the US banking market will compete for more than $115 billion in annual revenue, and there is also an opportunity to charge a 12 percent market premium to investors. (Nagarsheth, Arcati, & Desentis, 2022).

Furthermore, awareness, adoption, and impact of environmental, social, and governance (ESG) metrics in Asia has increased. This phenomenon is also reflected in a recent study by HSBC, which shows that the commitment to sustainable finance in the region is very strong and is quickly becoming a priority (Economist, 2022). Based on a survey from HSBC, there are three main factors that underlie ASEAN investors' concern for these ESG issues. First, there is pressure from employees, which is a major factor for 50% of investors. Second, regulatory requirements also have a significant impact, with 46% of investors responding. Third, there is recognition that paying attention to ESG issues can increase return on investment or reduce risk, which is a consideration for 40% of investors (HSBC Bank PLC., 2021).

Thus, there is a significant demand from stakeholders regarding information about ESG in companies. Investors want companies to disclose their ESG activities as best as possible so that they can use this information to compare companies in the same and across industries. Stakeholders want these disclosures to be based on generally accepted standards and the quality of the investor class (Tomac, et al., 2020). To meet the demand, companies prepare reports containing their performance in Environmental, Social, and Governance aspects separate from the company's annual financial statements. This report is referred to as the Sustainability Report. Various organizations issue frameworks nationwide to help companies publish Sustainability Reports, one of which is the GRI (Global Reporting Initiative) Standards. The GRI Standards are the most widely used and trusted sustainability reporting framework. The GRI organization issued this standard, has been adopted by many large corporations, and has become a reference in policy instruments and international stock exchanges (Global Reporting Initiative, 2023).

Application of ESG regulations in Asia Pacific is increasing rapidly due to the need for greater transparency and stricter definitions of sustainable investment products. In the last five years, the number of ESG policies in the region has more than doubled, and this is reflected in increased corporate ESG disclosures in most Asia Pacific markets. In fact, the level of ESG disclosure in this region is now equal to or even surpasses that in the United States (Goldman Sachs, 2022). The ASEAN region is becoming a world leader in sustainable business because companies are increasingly inclined to publicly disclose their impact (Global Reporting Initiative, 2023). Due to this, countries in ASEAN, including Indonesia, Malaysia, Singapore, Thailand and Philippines have regulations for supporting sustainable practices, which is publishing ESG or sustainability report. In Indonesia, OJK Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Service Institutions, Issuers, and Public Companies states that every financial company, issuer, and public company is required to prepare sustainability reporting. In 2016, public companies in Malaysia were required to publish sustainability reporting (Tomac, et al., 2020).

Singapore, through Singapore Exchange (SGX), also launched regulations related to sustainability reporting with the concept of "complyor-explain" and changed the provisions that were initially voluntary to become mandatory in 2016. This regulation requires all listed companies to publish sustainability reports annually. Another countries, Philippines, published a Sustainability Reporting Guidelines for Publicly Listed Companies in 2019 by Securities and Commission Exchange Commission in Philipines. Thailand also released a Corporate Governance Code in 2017 that specifies corporate boards make sure sustainability reporting follows a framework that is accepted and "proportionate to the company's size and complexity." (Tomac, et al., 2020)

From several phenomenon above, it can be said that applying ESG influences firm value. Studies conducted by Alareeni and Hamdan on US companies listed on the S&P 500 also states that ESG disclosure positively affects firm performance (Alareeni & Hamdan, 2020). There is a significant increase in the firm value of companies listed on the Malaysia Exchange due to the application of ESG to business (Wong et al., 2021). According to research conducted by Buallay at European banking companies, ESG significantly influences company performance (Buallay, 2019) . The study found the same result on G7 countries and 1,520 largest publicly listed companies (Almeyda & Darmansyah, 2019; Aydoğmuş et al., 2022).

On the other hand, several studies find no significant relationship between ESG implementation and financial performance. According to research conducted by Atan in Malaysia, there is no significant relationship between ESG and firm performance or firm values (Atan et al., 2018). The same thing was also found by Rahi, who researched the financial industry in Sweden, Denmark, Finland, and Norway, that there is a negative relationship between ESG and financial performance (Rahi et al., 2022). Research conducted on banking companies in Italy also states that ESG negatively affects company performance (Menicucci & Paolucci, 2022).

This study aims to find empirical evidence on how Enterprise Risk Management (ERM) and Environmental, Social, and Governance Performance affect firm value in the banking sector in Indonesia, Malaysia, Singapore, Thailand, and Philippine with the control variables Inflation and Firm Size. This research differs from previous studies because this study examines ERM and ESG simultaneously, which affect financial performance in the banking sector in these five countries. Previous research has examined separately how ERM influences firm performance in the banking sector and how ESG Performance influences firm performance in the banking industry. This study also use control variables such as inflation from the macroeconomic level variables and firm size from bank-level variables to determine whether these variables can affect financial performance in the banking sector. Based on the description above, the researcher will conduct research titled **"The Effect of Enterprise Risk Management and Environmental, Social, and Governance Performance to Firm Value (Empirical Study on Banking Sector in Indonesia, Malaysia, Singapore, Thailand, and Philippine)".**

1.2 Research Problem

This study examines the relationship between enterprise risk management and environmental, social, and governance on firm value in the banking sector. Based on the background explanation above, the problem formulation of this study is as follows:

1. How does enterprise risk management influence firm value?
2. How does environmental, social, and governance performance influence firm value?
3. How does enterprise risk management and environmental, social, and governance performance simultaneously influence firm value?

1.3 Research Objective

Based on the research problem above, the objectives of this research are:

1. Analyzing the impact of enterprise risk management on firm value
2. Analyzing the impact of environmental, social, and governance performance on firm value

3. Analyzing the impact of enterprise risk management and environmental, social, and governance performance on firm value

1.4 Research Benefits

1. For Academics

   As a resource to broaden knowledge and contribute to research on the subject of ERM and ESG.
2. For Banking Companies

   To assist management in improving the implementation of ERM and ESG in the banking sector to improve firm value.
3. For Investors

   As a material consideration for making investment decisions by considering ERM and ESG factors.
4. For Regulators

   As material for consideration in developing policies related to ERM and ESG in the banking sector in Indonesia, Malaysia, Singapore, Thailand, and Philippine.

1.5 Research Location and Time

The research will be conducted for two months, with one month for data collection and another month for data processing. The data is collected online by accessing the company's website to obtain annual report of banking companies Indonesia, Malaysia, Singapore, Thailand, and Philippine and the Refinitiv database to obtain the ESG Score.