

# Board Activity as a Catalyst in the ESG–Bank Performance Relationship: A Conceptual Framework

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## Abstract

In recent times, environmental, social, and governance (ESG) practices have become a central focus in corporate strategy and performance evaluation. Nonetheless, the relationship between ESG performance and bank performance remains complex and ambiguous. Thus, this conceptual paper aims to explore the relations between ESG performance and bank performance and further discuss the role of board activity in shaping the ESG performance and bank performance relationship. Grounded on stakeholder theory and agency theory, this study argues that effective governance oversight can alleviate agency problems and ensure that ESG activities align with shareholder interests, thereby enhancing financial and non-financial outcomes. This study develops a conceptual framework that explains how board activity moderates the ESG-bank performance nexus. This study contributes to board governance and ESG literature by offering a nuanced understand of governance mechanism such as board activity can catalyst the relationship between ESG-bank performance. Further, this study provides implications for policymakers and practitioners seeking to enhance corporate sustainability through governance structure.

**Keywords:** ESG Performance, Environmental Performance, Social Performance, Board Activity, Bank Performance

## Introduction

In today's business landscape, ESG activities have emerged as a prominent paradigm. ESG refers to how corporations and investors integrate ESG concerns into their business models (Senadheera et al., 2021). ESG is a term first introduced in June 2004 by the United Nations (UN) Global Compact initiative named "Who Cares Wins" to raise awareness of the importance of sustainability (Nizam et al., 2019). Following the Global Financial Crisis (GFC) of 2007/2008, corporations shifted their focus towards ESG activities to restore their market reputation by adopting socially responsible behavior (Shakil et al., 2019).

In the contemporary era, awareness has increased about the harmful impacts of climate change, social inequality, and immoral practices on humanity and the ecosystem among investors, entrepreneurs, and the public. As a result, integrating ESG activities is essential for businesses across all sectors to survive, thrive, and grow. In emerging countries, air pollution is a significant issue that poses a threat to both the environment and public health (Adardour et al., 2025; Gangwani & Kashiramka, 2024). Accordingly, ESG has become a cornerstone of modern business strategy. As of 2024, approximately 96% of the top 250 global firms (G250) and 79% of the top 100 domestic firms (N100) across 58 countries have adopted ESG reporting activities, a percentage that has remained unchanged since 2022 (KPMG, 2024). Hence, these trends in reporting demonstrate that firms including banks are expressing concern about ESG performance, indicating that banks are incorporating stakeholders' concerns in their business operations. This concern must be addressed by enhancing corporate financial performance, specifically by increasing profits.

Board activity is primary corporate governance mechanisms that reflect the distinct roles of banks' boards. Specifically, both the board of directors and executives are the core decision-makers in ESG matters, as they are responsible for the corporation's strategy and may be directly involved in enhancing ESG practices (Radu & Smaili, 2021). The board of directors plays an oversight role regarding ESG, ensuring that managers (agents) make the right ESG decisions. Board meetings are employed as a measure for board activity and board diligence (Lakshmana, 2008). Moreover, they are also recognized as a crucial component of sound corporate governance, serving as a medium for interaction and discussion among the board of directors. Thus, a higher number of board meetings indicates better oversight of the management, decreases the agency problems, and enhances decision-making and bank performance (Pant & Nidugala, 2022). Similarly, Gafoor et al. (2018) concluded that a higher number of board meetings is associated with better bank performance.

Notably, most prior studies have focused on the direct relationship between ESG and business financial performance, without considering corporate governance mechanisms as a moderating variable between ESG performance and bank financial performance. Therefore, according to this scenario and prior works, it is worthwhile to investigate areas that have not been previously explored by researchers, thereby contributing to the enhancement and enlightenment of the current literature on sustainable development.

To sum, this study focuses on two areas of research: ESG performance and board governance. It is reasonable to anticipate that board governance attributes, as represented in this study by board activity, may moderate the relationship between ESG performance and the financial performance of banks. Banks with effective corporate governance tend to perform better. For instance, banks with a higher frequency of board meetings experience improved ESG performance, which in turn enhances their financial performance. Collectively, this study highlights the role of board governance, represented by board activity as banks' directors have a direct relationship with management and stakeholders and play a vital role in enhancing banks' ESG performance. Thus, banks with better ESG performance contribute to enhancing their financial performance. Therefore, effective corporate governance mechanisms contribute to enhancing bank transparency, which consequently boosts investors' confidence, thereby improving the willingness of investors to invest in banks.

The remainder of this conceptual paper is organized as follows. The next section reviews the relevant literature, followed by the theoretical foundation and proposed conceptual framework on the moderating role of board activity. The paper concludes with key insights and recommendations.

## **Literature Review**

### *ESG Performance and Bank Performance*

Nowadays, ESG has become increasingly relevant for banks and financial institutions. ESG issues are an ethical concern and an economic one, as they have a direct impact on economic stability. The expectations of investors regarding the integration of ESG factors into their lending, investment, and product portfolios may pose a challenge for financial intermediaries (Menicucci & Paolucci, 2023).

The demand and awareness of ESG are not limited to advanced economies, as they also provide a competitive advantage in emerging economies. The relationship between ESG factors and bank performance has been investigated extensively in advanced economies. Moreover, the existing literature provides several arguments regarding the relationship between ESG and bank performance, with some indicating a favourable influence of ESG activities on bank performance, while others suggest an adverse impact. Note that certain research has indicated no significant association between ESG activities and bank performance (Smaoui et al., 2025).

Additionally, there are two conflicting views on the relationship between ESG and firm performance. The first view is that firms incur costs from investing in ESG activities, which may cause an economic disbenefit. On the other hand, other scholars argued that investing in ESG activities enhances firm performance, as investors prefer to invest in firms that are socially and ethically responsible. In an inclusive study, Al Hawaj and Buallay (2022) examined seven different sectors across 80 countries. They drew different conclusions about the relationship between ESG and enterprise performance. For instance, a positive relationship between ESG and return on assets is observed in the energy, manufacturing, retail, and tourism sectors, indicating that the return on assets generated by these sectors has exceeded the cost of disclosing ESG information.

Likewise, Chouaibi et al. (2021) reported a positive correlation between ESG practices and business performance. This outcome is consistent with signal theory, which signifies a link between ESG practices and firm performance. Moreover, firm value would increase in the case of strengthened ESG, and it would decline in the case of weakened ESG. Their study also revealed that green innovation fully mediates the link between ESG practices and firm performance. Similarly, Bahadori et al. (2021), Zhao et al. (2018), Bamel et al. (2025), and Bilyay-Erdogan and Öztürkkal (2023) assessed that good ESG performance enhances financial performance.

### *Environmental Performance and Bank Performance*

Based on stakeholder theory a positive relationship was evidenced between banks' environmental performance and financial performance. Thus, examining the individual components of ESG performance, the first component, namely environmental performance, refers to the firm's practices that help reduce its environmental impact. This includes policies

on water efficiency, energy efficiency, carbon emissions, waste management, and paper consumption. Moreover, all these practices will be taken into account when calculating the environmental score of the banks. As the main stakeholders for any industrial sector, the impact of financial institutions' environmental practices should be taken seriously. Although banks are not considered a polluting industry, their day-to-day activities could lead to high energy and paper consumption (El Khoury et al., 2021).

Correspondingly, banks contribute to environmental deterioration directly and indirectly. Their greenhouse gas emissions are directly linked to heavy energy-intensive infrastructure and paper consumption. Indirectly, through financing and investment activities in industries considered ESG sensitive, such as forestry and logging, oil and gas, mining, energy, and chemical companies (Gupta, 2025).

The banking sector must address its environmental obligations and stakeholder pressure when providing financing to firms that pollute and produce environmentally detrimental products. Furthermore, the banking sector also consumes environmental resources, such as paper and energy, and generates waste (Gallego-Álvarez & Pucheta-Martínez, 2020; Simpson & Kohers, 2002). Apart from the bank's internal policy on the environment, the policy related to lending activities will have a greater impact on the entire economic chain, as banks can determine which industries are considered low-risk and high-innovation borrowers (Gangi et al., 2019).

In the context of the banking industry, Buallay (2019) revealed that environmental performance is positively associated with banks' return on asset (ROA) and Tobin's Q (TQ). Moreover, Gidage et al. (2025) reported a positive and significant effect of environmental reporting on bank performance measured by ROA and return on equity (ROE), indicating that banks with higher environmental reporting tend to have better profitability. Bătae et al. (2021), on the other hand, reported that two dimensions of environmental performance, namely, emission and waste reductions, are positively related to bank performance. According to the stakeholder theory, and the empirical literature, this study develops the following hypothesis:

*Hypothesis 1a:* Environmental performance is positively associated with bank performance.

#### *Social Performance and Bank Performance*

Social factors include a firm's relationship with its employees, customers, society, and other stakeholders. A high level of social performance can have a favourable impact on the financial outcome through employee engagement, brand reputation, and reduced regulatory risks. Banks' engagement in social activities has witnessed a positive influence on their financial performance (Alghafes et al., 2024).

Furthermore, social performance refers to a corporation's behaviour towards its staff, society, and customers, characterized by its social responsibility in the products and services it offers (Miralles-Quirós et al., 2019). For instance, this includes incorporating fair competition policy, practicing business ethics, providing a channel for customer complaints and satisfaction, and giving donations. Apart from that, the bank can also incorporate socially oriented policies, such as health and safety, training and development, diversity and opportunity, and pay and reward policies, to improve its social performance.

Other studies also documented a positive relationship between social performance and corporate financial performance in diverse markets (Alghafes et al., 2024; Cornett et al., 2016; Moufty et al., 2021; Platonova et al., 2018; Shakil et al., 2019; Siueia et al., 2019; Waddock & Graves, 1997; Wu & Shen, 2013).

Contrary to the previous findings, Gupta (2025) determined that banks' social activities obstruct bank performance. This may be attributed to the high cost of its sustainability practices, which are offset by lower benefits. In the context of banks in Southeast Asia, Gutiérrez-Ponce and Wibowo (2024) revealed that banks' social activities do not influence bank performance. Furthermore, considering the social aspects of ESG, better product responsibility results in a decrease in accounting profitability (Menicucci & Paolucci, 2023). Based on to the stakeholder theory and empirical evidence, the following is hypothesized:

*Hypothesis 1b:* Social performance is positively associated with bank performance.

#### *Board Activity*

Board activity is measured by number of board meetings hold in a year. Board meetings play a crucial role in determining the firm's achievement, which also serves as a significant platform for effective decision-making of a firm, discussing various issues related to the firm (Kakanda et al., 2016). Additionally, it was also mentioned that the monitoring authority and effectiveness of board members can be measured by the number of board meetings held in a year (Lipton & Lorsch, 1992). The frequency of board meetings is a vital indicator for evaluating the effectiveness of independent directors' roles (Hossain & Oon, 2022). Thus, it was suggested that firms conducting more frequent board meetings would perform better.

Similarly, Paul (2017) empirically studied the effect of board activity on firm performance and identified that enhancing board activity contributes to improved firm performance. In a panel Generalized Method of Moments (GMM) regression, Al Farooque et al. (2020) asserted that the frequency of board meetings is positively linked to firm performance. This suggests that directors can utilize meetings to evaluate executives' activities, thereby encouraging them to perform better and ultimately enhance firm performance.

Furthermore, the frequency of board meetings suggests a proactive board. The frequency of meetings enhances top management supervision of the bank, making the advisory role more applicable, which in turn contributes to improved bank performance (Liang et al., 2013). Hence, the authors concluded that the number of board meetings contributes to enhanced bank performance. Similar findings were reported by the study of De Andres and Vallelado (2008), which demonstrated that board meetings contribute to enhancing bank performance. Their study was conducted on 69 commercial banks from Canada, France, the United Kingdom (UK), Italy, Spain, and the US, spanning from 1995 to 2005.

Therefore, it is evident that the frequency of board meetings on the corporate board plays a crucial role in enhancing financial performance. According to the argument of agency theory and the empirical evidence from prior literature. This current study proposes the following hypothesis:

*H2: Board activity reinforces the relationship between ESG performance and bank performance*

*H2a: Board activity reinforces the relationship between environmental performance and bank performance.*

*H2b: Board activity reinforces the relationship between social performance and bank performance.*

### Conceptual Framework

Figure 1.1 below illustrates the conceptual framework of the study, which is based on the theories and literature reviewed. Thus, the current study's conceptual framework aligns with its objectives. Furthermore, it attempts to investigate the impact of ESG performance, environmental performance and social performance as independent variables on promoting banks' performance. Bank performance is measured by ROA, ROE, Net Interest Margin (NIM), and TQ. Moreover, including the board activity as an interaction variable can enhance the association between the previously mentioned variables. In addition, this study includes the following as control variables: bank size, financial leverage, loans to deposits, gross domestic product (GDP) growth rate, and the inflation.

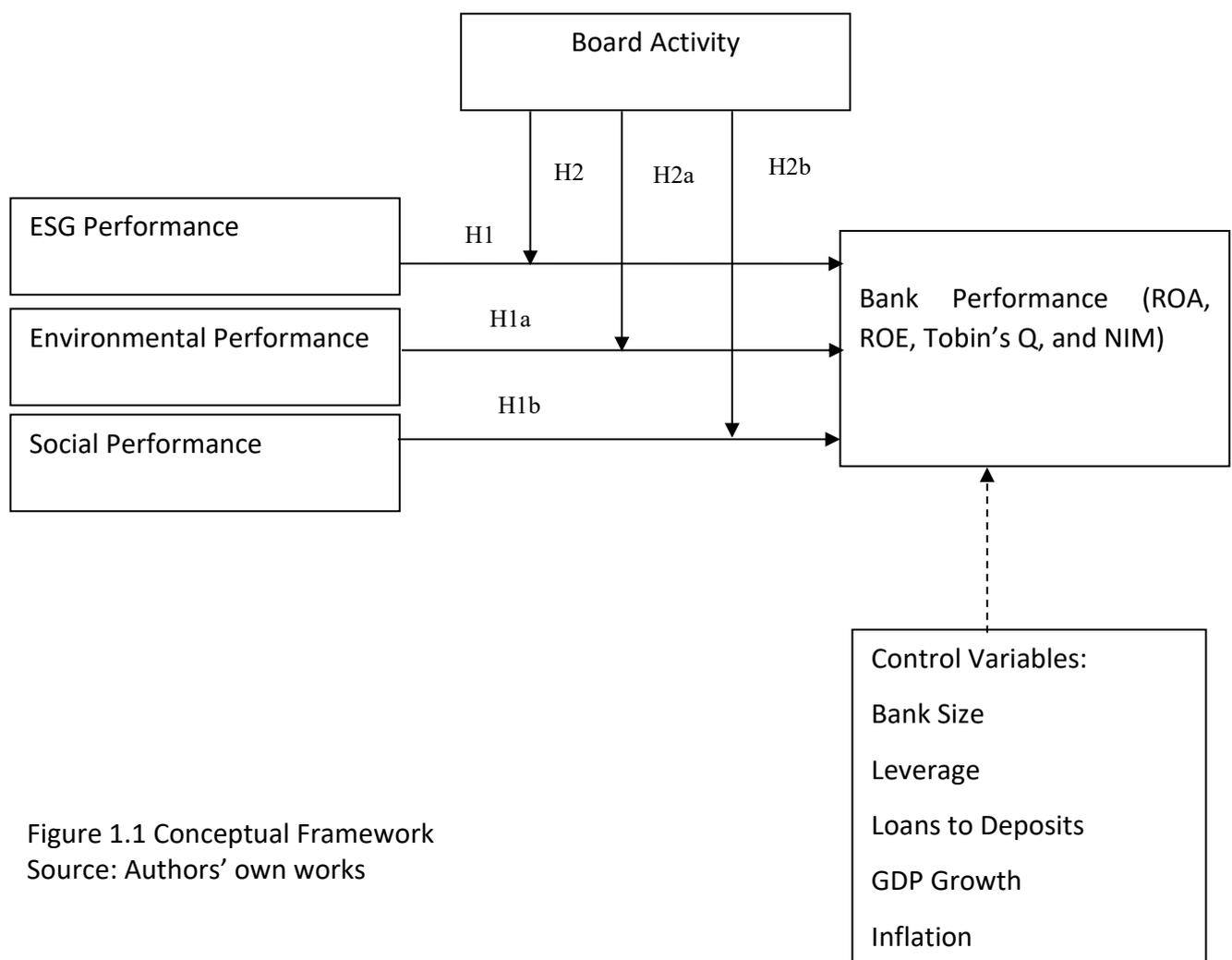


Figure 1.1 Conceptual Framework  
Source: Authors' own works

## **Theoretical Framework**

### *Stakeholder Theory*

Stakeholder theory is considered a prevailing theory in ESG studies, originating from Freeman (1984). According to Freeman (1984), firms (including banks) exist for the objective of meeting the interests of stakeholders. Thus, having a strong relationship with multiple stakeholders helps the bank achieve its objectives. This theory suggests that managers should prioritize building strong relationships with all stakeholders, not just shareholders (Melé, 2008).

On the other hand, Freeman (1984) defined stakeholders based on a “wide definition”. Stakeholders are defined as “any group or individual who is affected by or can be affect the achievement of an organization’s objectives.” Additionally, he defined stakeholders based on a “narrow definition,” which includes “those groups without whose support the organization would cease to exist.” In this regard, stakeholders include clients, suppliers, vendors, staff, investors, communities and others who is related to the organization. All stakeholders, including shareholders, are directly or indirectly affected by the bank’s wealth creation and activities. Hence, banks should be responsible towards them (Moufty et al., 2021).

Stakeholder theory provides a theoretical framework for examining the relationship between ESG performance and bank performance, as ESG performance is also a component of non-financial performance. ESG practices are viewed as a means of stakeholder engagement to meet those expectations, which in turn lead to improved financial performance. Therefore, maintaining a good relationship with all stakeholders enhances both operational and financial performance (Yilmaz, 2021).

### *Agency Theory*

Agency theory elucidates the relationship between the principal (shareholder) and the agent (manager), where the shareholder hires the manager and anticipates that the manager will work in the best interest of the corporation (Jensen & Meckling, 1976). Moreover, the benefits of investing in ESG initiatives are long-term, while managers often focus on short-term investments to improve financial performance, potentially leading to information asymmetry between shareholders and managers. Managers may be unwilling to invest in projects that do not yield an immediate financial advantage (Wellalage & Kumar, 2021).

On the other hand, Jensen and Meckling (1976) defined the agency relationship as “a contractual relationship between two or more persons in which one party (the principal) engages the other party (the agent to conduct some tasks, including decision-making, on behalf of the principal.” In this regard, there will be a separation between the ownership and control of the firms. Thus, the issue of misalignment of interest between principal and agent arises, which then causes the agency problem (Gillan & Starks, 2003). In addition, Fama and Jensen (1983) stated that agency costs will be incurred due to conflicts of interest between agents and principals

According to agency theory, effective governance oversight can alleviate agency problems and ensure that ESG activities align with shareholder interests. Therefore, the corporate governance mechanism, particularly the board structure, plays a vital role in controlling and directing managers’ actions toward shareholders’ interests, while reducing agency costs (Hussain et al., 2018).

### **Conclusion and Recommendations**

This conceptual paper concludes that ESG performance, environmental performance and social performance plays a critical role in enhancing bank performance. Most literature investigates the impact of ESG on business performance and yielding ambiguous findings and do not track the role of board activity in this association. Moreover, despite the growing recognition of the role of corporate governance in fostering ESG, there are still significant gaps in the literature regarding the specific mechanism through which governance structure impacts the ESG and bank performance relationship. This includes board activity an interaction variable on the aforesaid relationship would give additional insight into how this interaction variable could impact ESG performance and the banks' performance relationship.

This conceptual paper provides several contributions to ESG and governance literature. Theoretically, this study aims to evaluate the applicability of relevant theories, namely stakeholder theory and agency theory, in the conceptual framework of this study. Besides, developing existing knowledge by interacting with ESG and bank performance within governance mechanisms and placing board activity as one of the governance mechanisms on the board as a key moderating condition that explains how ESG can be translated into better financial outcomes. Contextually, this paper is particularly relevant for emerging market countries where ESG is gaining momentum. In such an environment, governance structures may not fully align with ESG expectations.

Notably, the study further underlines the importance of ESG, the environmental and social performance, in enhancing bank financial and market performance. Banks can enhance their financial and market performance by increasing their engagement in ESG, environmental, and social activities. Thus, practitioners should encourage banks to prioritize ESG, environmental, and social practices in their operations, as this leads to enhanced bank performance and supports sustainable outcomes.

Furthermore, regulatory authorities and governments can encourage banks to engage more in ESG-related activities and assist them in enhancing their disclosure practices and increasing transparency. Hence, this could help to maintain better bank performance. Banks with greater transparency tend to attract more investors and perform better in the long run. Conversely, banks with higher ESG ratings, those that frequently convene board meetings, might perform better financially. Additionally, this study could be favourable to regulators and policymakers in enhancing corporate governance practices by encouraging regular board meetings. Subsequently, regulators and policymakers should implement reforms designed to facilitate more board meetings. Given that, thus study does not include an empirical investigation, therefore, we encourage future researcher to empirically investigate the interaction of board activity in the relationship between ESG performance and bank performance.

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