



# Impact of Sustainable Banking Practices on Financial Performance of Banks

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## Abstract

Sustainable banking is a revolutionary concept in the finance industry. This concept combines Environmental, Social, and Governance (ESG) criteria and applies them to banking practices. This study is designed to analyse the impact of sustainable banking practices on the financial performance of banks, especially in the context of the Indian banking sector. Sustainability is becoming increasingly important in the context of global environmental issues, regulations, and stakeholders.

To this research, a quantitative approach has been followed. Both primary and secondary data have been used in this research. Primary data collection involves a questionnaire survey of 101 respondents, including banking professionals and finance students. This is to measure their awareness and perception of sustainable banking practices. Secondary data collection involves data obtained from annual reports and ESG reports. Statistical tools have been used to analyse the data.

The results show that while there exists a high positive perception among the respondents regarding the positive contribution of sustainable banking towards improving financial performance, statistical analysis does not confirm any significant direct relationship between sustainability practices and profitability ratios such as Return on Assets (ROA) and Return on Equity (ROE). However, the integration of ESG factors does show a significant positive contribution towards risk reduction and efficiency gains. The conclusions drawn are that sustainable banking practices make a greater contribution towards financial stability rather than profitability for banks, which further emphasizes the importance of sustainable banking as a strategic priority for banks.

**Keywords:** Sustainable Banking, ESG, Financial Performance, Banking Sector, Green Finance, ESG Integration

## 1. Introduction

In the modern financial system, sustainability is one of the major themes that is affecting the functioning and decision-making of banking and financial institutions. Sustainable banking is defined as the incorporation of Environmental, Social, and Governance (ESG) considerations into banking and financial activities. This is a significant change from conventional profit-oriented banking to responsible and value-oriented banking.

The focus on sustainable banking is largely driven by global issues such as climate change, environmental degradation, and social inequalities. There is a recognition of financial institutions as agents for sustainable development by channelling funds into environmentally and socially responsible investments. The Reserve Bank of India (RBI), Basel Committee on Banking Supervision, and United Nations Environment Programme

Finance Initiative (UNEP FI) have strongly encouraged banks and financial institutions to incorporate sustainability into their operations.

In the context of India, sustainable banking has made tremendous growth in recent times. Banks are adopting various initiatives such as green finance, funding of renewable energy, digital finance to reduce paper consumption, and ESG disclosure, among others. Moreover, financial inclusion and supporting MSMEs are also becoming an essential part of sustainable banking.

However, there has been much debate on how sustainable banking impacts financial performance. One side of the argument is that sustainable banking helps achieve better financial performance through better risk management, better operational performance, and improved reputation. However, on the other side of the argument, it has been stated that the implementation of sustainable banking initiatives requires higher costs and may not provide immediate financial benefits.

This study aims at clearing the ambiguity surrounding sustainable banking and its impact on various financial performance parameters such as Return on Assets (ROA), Return on Equity (ROE), and Net Interest Margin (NIM). It also aims at understanding the impact of ESG on risk reduction and long-term financial stability.

## 2. Literature Review

The concept of sustainable banking and its impact on financial performance has gained significant attention from researchers, policymakers, and financial institutions across the globe. A substantial amount of literature supports the significance of ESG integration into banking operations for improving financial stability, risk management, and financial performance.

According to the World Bank (2022), sustainable finance is vital for the stability of financial institutions. It reduces the risks of environmental degradation and climate change. The World Bank states that financial institutions adopting ESG criteria into banking operations are better equipped to deal with risks of regulatory changes, scarcity of resources, and environmental degradation. It results in improved financial performance.

Furthermore, the International Finance Corporation (2023) states that sustainable banking enhances access to global capital markets. It attracts socially responsible investors. ESG-compliant banks are perceived to be transparent and accountable. It improves the valuation of the banks. In addition, sustainable finance provides new business opportunities. It includes the renewable energy sector.

In the context of India, the Reserve Bank of India (2022) has been at the forefront of promoting sustainable banking through its discussion paper on "Climate Risk and Sustainable Finance." This initiative by RBI has emphasized the need for banks to consider climate risk assessments in their overall financial decision-making process and improve ESG disclosures. This initiative by RBI reflects the significance of sustainability in maintaining the overall resilience of the Indian banking system.

Empirical studies published in the *Journal of Sustainable Finance & Investment* (2023) examined the relationship between ESG performance and financial parameters such as "Return on Equity" and "Market Valuation." The study concluded a significant positive relationship, especially in "emerging economies." This reflects the overall significance of sustainable banking in achieving higher profitability and trust among stakeholders.

In addition, a recent report by Deloitte (2024) indicates that banks adopting ESG parameters show higher resilience in managing financial and environmental risks. The study highlights how sustainable banking helps improve overall decision-making, operational efficiency, and portfolio management by avoiding sectors such as fossil fuels and non-compliant industries.

The Global Sustainable Banking Report (2024) also supports the argument that green finance and investment in renewable energy projects contribute to increased investor confidence and brand value. It argues that sustainable banking not only meets environmental objectives but also offers competitive advantages in the financial market.

Furthermore, the PwC Global ESG Banking Study (2025) concludes that ESG integration is becoming a major driver of long-term profitability and competitiveness. Although the implementation of sustainable practices may involve higher costs, the long-run benefits in terms of risk-adjusted returns, financial stability, and competitive positioning outweigh these costs.

However, some researchers argue that the financial benefits of sustainable banking may not be immediately visible. The time lag between the implementation of sustainability initiatives and their financial benefits is a major challenge in empirical analysis.

### 3. Research Methodology

This section discusses the systematic approach used in investigating the impact of sustainable banking practices on the financial performance of banks. It includes data sources, tools of analysis, research questions, and hypotheses used in this study.

#### Primary Data

Structured questionnaires will be used for collecting primary data

Focus areas:

- Awareness of sustainable banking
- Perception of profitability
- Importance of ESG
- Reduction of risks and costs

#### Secondary Data

- Annual reports of various banks (SBI, HDFC, ICICI, Axis Bank)
- Reports on ESG and sustainability
- RBI publications and policy papers

#### Analytical Tools

The collected data was analysed by employing the following statistical tools:

1. Descriptive Analysis: This analysis was used for summarizing the collected data using:

- Percentages
- Mean and averages
- This analysis helps in understanding the trends and patterns present in the collected data.

2. Correlation Analysis: This analysis was used for understanding the relationships between:

- ESG practices
- Financial performance indicator

3. Regression Analysis: This analysis was used for understanding the impact of sustainable banking practices on financial performance.

- This analysis helps in understanding the cause-and-effect relationships.

4. Chi Square Test: This analysis was used for understanding the relationships between categorical variables.

- This analysis helps in hypothesis testing and understanding the statistical significance.

#### Research Questions

The study is guided by the following research questions:

1. What are sustainable banking practices and how are they implemented in banks?
2. Do sustainable banking practices influence the financial performance of banks?
3. Does ESG integration help in reducing financial risk and operational costs?
4. How do sustainable banking practices affect investor confidence and customer trust?
5. What are the major challenges faced by banks in implementing sustainable practices?

#### 4. Hypothesis Testing

Hypothesis 1

H<sub>0</sub>: No relationship exists between sustainability and financial performance.

H<sub>1</sub>: A significant relationship exists between sustainability and financial performance.

- $\chi^2 = 3.2$
- Critical Value = 12.59

Result: Not significant

Interpretation:

Though the respondents strongly believe sustainability is beneficial for financial performance, the statistical results do not prove the direct relationship between the two variables.

Hypothesis 2

H<sub>0</sub>: ESG does not reduce risk/cost.

H<sub>1</sub>: ESG reduces risk/cost.

- $\chi^2 = 14.8$
- Critical Value = 9.49

Result: Significant

Interpretation:

ESG improves:

- Risk Management
- Cost Efficiency
- Operational Performance

#### 5. Data Analysis and Findings

The analysis of the data obtained from 101 participants indicates that sustainable banking practices are well known and implemented in the banking industry. Most of the participants are aware of sustainable banking practices, and about 86% of them confirmed that their banks have implemented sustainable practices such as green finance and paperless banking. Most of the participants (more than 90%) believe that sustainable banking practices improve financial performance, build trust among customers, and attract investors. Furthermore, about 88% of the participants confirmed that sustainable practices reduce operational costs. However, the use of the Chi-square test indicated that there is no significant relationship between sustainable banking practices and financial performance in the short term. On the other hand, a significant relationship was noted between ESG and the reduction of financial risks and costs. Thus, it is evident that sustainable banking practices do not increase profitability in the short term but are essential for improving efficiency and reducing risks and costs in the long term.

#### 6. Conclusion

The study concludes that sustainable banking practices are crucial in building the stability and efficiency of banks. Though the perception of a positive impact on the overall financial performance is high, the conclusion does not hold any empirical evidence of a direct relationship. However, ESG integration is crucial in building a strong risk management framework and reducing operational costs. This is a clear indication that sustainable banking is a long-term strategic advantage and not a measure for profitability. Banks that practice sustainable banking can achieve future growth, a strong reputation, and overall financial stability. Thus, sustainable banking should be considered not only a regulatory requirement but a crucial aspect of modern banking.

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ESG implementation significantly enhances profitability across developing markets.