

# Impact of Environmental, Social Governance (ESG) on Bank Group performance in India

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**Article Type:** Article

**Article Citation:** Anandi Sarkar Pyne and Amirul Sardar, Impact of Environmental, Social Governance (ESG) on Bank Group performance in India. M.S. Ramaiah Management Review. 2024; 15(03), 38-47. DOI: 10.52184/msrnr.v15i03.000

**Received date:** June 01, 2024

**Accepted date:** September 01, 2024

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**Abstract:**

With the objective to accomplish SDGs 8, 9, 12, 13, and 16, the performance of 33 listed banks from various bank groups is analysed with regard to ESG variables. The Environmental, Social, and Governance performance ESG ratings individually and collectively are taken into account in the study. Accounting measures like Return on Assets (ROA), Return on Equity (ROE), and Tobin's Q are used to analyse financial performance.

According to research, there is a relation between ESG and financial performance of banking institutions. The study emphasises the profitability as the financial performance (FP) measure, and level of ESG investment, ESG can have a different impact on FP. According to the report, the size of ESG investments still have a beneficial impact on market performance but no longer have a substantial impact on Indian bank groups' accounting performance. In order to maximise their investments and generate optimal returns, the report advises banks to pinpoint ESG as a tipping point.

**Keywords:** ESG, Bank groups, Environmental, Social, Governance.

## Introduction

After the 1987 Brundtland Report, People and Organizations Started giving the importance of Sustainability in

Conserving the Environment which in turn Progression the Society's health. Several Governments around the world offer Significant tax Incentive for using Sustainable options. Man made Climate

change is a most oppressing moments for us for that Sustainable business practices of industries are crucial in meeting the global and country specific climate targets and Sustainable Development Goals. Industries in India are being engaged in ESG practices which are considered as a critical factor for the Companies as well as the investors. ESG as we know it evolved from several older Sustainability frameworks including EHS & CSR, more focus on companies' right thing to do for the society but in case of ESG, face the different issues using Business lens.

Since there are few research demonstrating the link between ESG and Indian bank performance, the study looks into how ESG impacts the financial performance (FP) of Indian banks. Regulatory Bodies that peddle to Bank & Financial institution to consider ESG in their risk management framework. Banks have the potential to access various revenue streams driven by ESG principles (Financial Express). Stakeholders are also concerned with ESG disclosures (Siew et al. 2013 a, Sharma et al.2020). From the research of the last decade, we can conclude that there is a shift of goal orientation of corporate houses from profit maximizing to sustainable development through ESG.

ESG in banking refers to the banking industry's consideration of environmental, social, and governance aspects. As Bank is an important financial intermediary in the money market working as a liaison between lender and borrower and play an important factor for the economic development of a country we need a measure of sustainability for these banks. Bank performance on environmental, social, and governance attributes can be considered as a significant sustainability measure, especially their policies, standards and performance (Scholtens & Klooster, 2019).ESG of Indian Banking Sector is mainly driven by the Reserve bank

of India .ESG is a non-financial activities practised by firm for value maximization of both company and all stakeholders. ESG activities and reports improve the value of the firms positively when other factors stay constant (Fatemi et.al. 2018, Naeem et.al.). Consequently, businesses driven by the sustainability resulted in faster growth rate, better profitability and controlled cost (Naeem et.al.).

Banking intermediaries are obligated to offer better interest rates to corporate houses that adhere to ESG standards. SEBI introduced compulsory ESG reporting for listed companies in 2020, accenting the need for transparency, accountability, and disclosure of ESG-related information. This implantation emboldens banks to incorporate ESG factors in their decision-making process and disclosure their ESG performance to Stakeholders. The RBI has also punctuated the integration of ESG factors in the banking sector through its Sustainable Finance Framework and Sustainable Banking Principles. This encourages banks to align their lending practice with SDGs and promote responsible banking. Banking Industries have an indirect impact on Environment and Social factors. So, information on ESG of Banks influence the Shareholders investment decision. Banking institutions will enable themselves in bifurcating the environmental commitments, the commitment of social responsibilities, and the policies of the governance quality to the customer and business partners (Oana Marina Batae et al.).

The recent research are reporting that ESG emerged as significant determinants of bank's financial performance in the Indian context. Integrating ESG considerations into banking practices can help institutions mitigate risks, enhance their reputation, attract investors, and contribute

to sustainable development. As ESG awareness continues to grow, it is crucial for banks in India to prioritize the incorporation of ESG factors into their strategies to ensure long-term financial resilience and positive societal impact.

## Review

The Coordination of ESG and the individual factors into business practices acquired significant remark globally, including within the Banking Industries. ESG considerations in Business go beyond traditional financial prosody and enclose environmental stewardship, Societal obligation effective Corporate Governance.

The review enquire relationship of ESG factors and FP of Indian banks, highlighting existing research and identifying key findings. Friede, Busch and Bassen (2015) examined more than 2,000 empirical studies and suggests that companies with better ESG practices tend to achieve superior financial results over the long-term.

The (ESG) factors into banking practices have obtained Peculiarity in recent years. A Study by Iyer, Puri, and Zhang (2020) found that banks with higher ESG score proved lower credit and operational risks, leading to improved financial Performance. This suggests that ESG factors can enhance a bank's risk management capabilities and profitability.

ESG factors can contribute to risk Subsidence, leading to enhanced financial performance. A study by Ammann, Oesch and Schmid (2020) indicated that banks with better ESG performance exhibit lower borrowing costs and reduced risk, thereby improving their financial performance. Studies have shown that Firms which are following ESG factors, efficiently mitigate

different types of risks associated with environmental liabilities, social controversies, and governance failures. This ability to mitigate risk can positively impact financial performance by reducing volatility and enhancing resilience.

Different Studies exponent that incorporating ESG factors into business can facilitate long-term value creation. Research by Eccles, Loannou, and Serafeim (2014) demonstrates that companies with strong ESG performance exhibit higher profitability, improved operational efficiency, and greater innovation, all of which contributes to Sustainable financial performance over time.

Several studies all over the world including India conducted research on ESG & FP. For instance, Bandyopadhyay, A., Barua, S., & Bhattacharjee, S., 2020, concluded that better ESG performance positively influenced profitability, asset quality, and market valuation. Gutierrez-ponce, H: Wibowo, when ROA and ROE are used, the link between ESG and FP is unfavourable. The study, believes that environmentally sensible firms get competitive advantage like increase corporate image, awareness, and intangible assets.

A research has explored ESG practice and a bank's cost of capital. Several Studies suggest that banks with robust ESG practices attract more socially responsible investors, leading to a decrease in the cost of capital. ESG factors have been linked to loan portfolio quality and credit risk in banking. Research by Bertoni, Cambini and Damonate (2019) found that banks with higher ESG scores had lower non-performing loan ratio, indicating better loan portfolio quality. This relationship suggests that a bank's consideration of ESG factors in lending decision can result in improved financial performance by reducing credit risk.

The regulatory environment is vital in the integration of the ESG factors in banking institutions. Gartzert and Kosub, 2019, found that banks operating in regions with stricter ESG regulations experienced better financial performance, suggesting that regulatory support can incentivize ESG integration and enhance bank performance. The disclosure of ESG information by banks has implications for investor perception and financial performance. Research by Qu, Hasseldine and Tran (2021) demonstrated that banks with ESG disclosure were lower information asymmetry, higher investor demand and leading to improved financial performance.

Investors perception regarding ESG matter can influence Banks financial performance. A study by Belkaoui et.al (2017) suggested that banks with better ESG Performance attract more investments and experience lower costs of capital. Investors increasingly consider ESG factors as indicators of a bank's long-term sustainability and responsible business practices, which can positively impact financial performance. The regulatory environment surrounding ESG factors can influence bank financial performance. Research by Hoepner et al. (2016) found that banks operating in countries with stricter environmental regulations tend to exhibit better financial performance due to reduced reputational risks and improved operational competence.

The growing trend of socially responsible investing (SRI) has implications for bank financial performance. Banks offering ESG related financial products & services that attract SRI investors, leading to increased deposits and revenues. Furthermore, research by Dissanaiké, Gregoriou, and palaniappan (2014) indicated that SRI-driven investments positively impact bank

performance by improving asset quality and reducing default risk.

Environmental performance focuses on a bank's efforts to conceal climate change, natural resource management and reduce pollution. A study by Reddy, K.S., and Sahoo, P.(2018) findings reveal that banks with better environmental performance indicated superior financial performance.

Social performance encompasses of a Bank, customer relations, and employee welfare and community development. Hillman and Dalziel (2020) study indicated that stronger Governance tends to better financial performance. Adams et al. (2017) studied expressed that Corporate Governance is positively related to financial performance.

Different article examined relationship of ESG factors and bank's ROE. Smith et al. (2018) found, ESG factors are positively related to banks' profitability including ROE. According to the Agency Theory management's focus on short-term profits may lead to a neglect of ESG factors, potentially resulting in a weaker link between ESG and ROE.

Maqsood et al. (2019) conducted a meta-analysis study in European banking sectors which revealed no significant association between ESG factors and bank's ROA.

Diouf et al. (2020) found that ESG performance had no significant impact on Bank's ROA.

While the existing literature gives us mixed findings regarding ESG and ROA, ROE. Some Of suggest a positive relationship, and some of others indicate a negative relationship. Therefore, there is a need for further investigation to better understand the nature and nuances of this relationship.

A more thorough analysis of the relationship of ESG Practise and Corporate CFP in the Banking Industries, especially in

the Indian context, will result from filling in these research gaps. Further, the research will identify the specific mechanisms and drivers that can enhance the integration of ESG factors into banking practices and promote sustainable financial performance.

## Research Objectives

This study's goal is to analyse the correlation between the financial success of the banking industry and ESG performance both separately and together. In particular, the study aims to investigate how ESG factors impact profitability measures.

## Methodology

In order to analyse the connection between ESG performance and FP in the banking sector, this research employs a quantitative research design. The research design will involve multivariate regression analysis and correlation covariance analysis of public and private sector bank groups, the hypotheses that need to be tested.

## Sample Selection

The study will focus on 33 public and private sector India-based banks in operation. The selection of banks is based on their availability of ESG data and financial performance information. A purposive sampling approach is used to ensure representation from both public and private sectors.

## Data Collection

The study will utilise the secondary data gathered from the financial statements,

annual reports, and sustainability reports of the chosen banks. ESG data will be collected from reputable source of CRISIL. Financial performance data, including ROA, ROE, Tobin's Q and NPA will be extracted from financial statements.

## Variables

The performance of the governance system, the social system, and the environment will be the independent factors in this study. Financial performance metrics such as ROA, ROE, and Tobin's Q will be the dependent variables.

## Results

The collected data will be analysed using statistical software packages such as SPSS. Descriptive statistics, Correlation, ANOVA and Multivariate Regression model were used to provide an overview of the variables. To investigate the connections between ESG elements and financial performance measures, correlation analysis will be carried out. To evaluate how ESG factors affect ROA, ROE, and Tobin's Q, multivariate regression analysis will be used.

$$Y = \beta_0 + \beta_1 X + \epsilon$$

Where,

Y = Vector containing two dependent variables, Y1, Y2, Y4 and Y5.

X = Independent Variable

= Vector of intercept for Y1, Y2, Y3 and Y4

= Vector of coefficients representing the effect of the independent variable on Y1, Y2, Y3 and Y4.

$\epsilon$  = Error Terms

## Hypothesis Testing

Based on the research objectives, specific hypotheses will be formulated to test the relationships between ESG factors and financial performance measures. These hypotheses will be tested using appropriate statistical tests, such as t-tests or F-tests, to determine the significance and direction of the relationships. Hypothesis based on the literature is stated as follows: -

- H01a The financial performance of the public sector bank groups has no significant relationship with Environmental, Social Governance (ESG) performance.
- H01b The financial performance of the public sector bank groups has no significant relationship with individual factors of ESG, Environmental, social and governance performance.
- H02a The financial performance of the private sector bank groups has no significant relationship with Environmental, Social Governance (ESG) performance.
- H02b The financial performance of the private sector bank groups has no significant relationship with individual factors of ESG, Environmental, social and governance performance.
- H03a The financial performance of the bank groups is not significantly related with Environmental, Social Governance (ESG) performance.
- H03b The financial performance of the bank groups is not significantly related with the individual factors of Environmental, Social Governance (ESG) performance.

The ROA, ROE, Tobin's Q, and NPA metrics are used to measure the financial performance of public sector bank groups. When we examine the correlation

covariance matrix, we uncovered a modest correlation (0.32) between ROA and ROE and a large correlation (0.62) between ROE and ROA (Table 1). Tobin's Q correlation matrix, however, shows a positive correlation (0.57) between bank financial performance and ESG. In addition, a multivariate regression analysis is performed, and the results indicate a substantial correlation between financial performance and ESG performance, as indicated by a p value less than 0.05.

The environmental performance of public sector bank groups, on the other hand, appears to have a considerable association with ROA, which is corroborated by correlation analysis. Environmental performance is strongly correlated with ROA (0.69) and slightly correlated with ROE (0.48). However, neither ROA nor ROE measurements have shown any conclusive evidence of a relationship between social and governance performance. However, the correlation study shows that the performance of social and governmental institutions is only very weakly negatively connected with ROA (-0.1) and (0.02), and only very faintly favourably correlated with ROE (0.36) and (0.43). Further Tobin's Q research, however, revealed that social performance ( $r = 0.53$ ) and governance factor ( $r = 0.48$ ), respectively, have a favourable relationship with financial performance. Additional regression analysis reveals a substantial correlation between overall ESG performance and social and governance performance. However, ANOVA is used to test the hypothesis, which suggests that there exists a significant relation between public sector bank performance with ESG and its individual factors. Thus, H01a and H01b is rejected.

**TABLE 1:** CORRELATION MATRIX FINANCIAL PERFORMANCE OF PUBLIC BANK GROUPS AND ESG

	ROA	ROE	E	S	G	ESG
ROA	1.00	0.42	0.69	-0.10	-0.02	0.32
ROE	0.42	1.00	0.48	0.36	0.43	0.62
E	0.69	0.48	1.00	-0.14	0.00	0.49
S	-0.10	0.36	-0.14	1.00	0.58	0.56
G	-0.02	0.43	0.00	0.58	1.00	0.85
ESG	0.32	0.62	0.49	0.56	0.85	1.00

Based on a correlation covariance matrix (table 2), the private banks, which make up the other dimension of the bank group, indicate that there is a marginally positive link between ROA and ROE and the performance of ESG and governance. Negative correlations have been found between ROE and social and environmental factors. ROA and environmental factors do, however, correlate positively. Regression studies, F tests, and T tests, on the other hand, reveal that there is no significant correlation between the financial performance of private sector Indian banks and ESG and its constituent parts. A distinct image is shown by Tobin's Q, which reveals a strong correlation between bank success and ESG, social, and governance performance, based on regression research. ANOVA analysis of financial performance of private sector bank groups with ESG suggests a significant relationship between private sector banks and ESG. Thus, null hypothesis is rejected.

**TABLE 2:** CORRELATION MATRIX FINANCIAL PERFORMANCE OF PRIVATE BANK GROUPS AND ESG

	ROA	ROE	E	S	G	ESG
ROA	1.00	0.91	0.14	-0.13	0.14	0.13
ROE	0.91	1.00	-0.05	-0.02	0.28	0.23
E	0.14	-0.05	1.00	-0.01	-0.07	0.19
S	-0.13	-0.02	-0.01	1.00	0.55	0.68
G	0.14	0.28	-0.07	0.55	1.00	0.95
ESG	0.13	0.23	0.19	0.68	0.95	1.00

**TABLE 3:** FINANCIAL PERFORMANCE AND ESG CORRELATION MATRIX

	Tobin's Q	ROA	ROE	E	S	G	ESG
Tobin's q	1.00	0.41	0.27	0.39	0.53	0.48	0.57
ROA	0.41	1.00	0.82	0.13	0.17	0.20	0.27
ROE	0.27	0.82	1.00	0.16	0.29	0.31	0.33
E	0.39	0.13	0.16	1.00	0.47	0.52	0.68
S	0.53	0.17	0.29	0.47	1.00	0.81	0.89
G	0.48	0.20	0.31	0.52	0.81	1.00	0.94
ESG	0.57	0.27	0.33	0.68	0.89	0.94	1.00

The theory is put to the test using an ANOVA. The research revealed that the F value does not fall within the crucial range, allowing for the rejection of both H03a and H03b as the null hypotheses. We can therefore draw the conclusion that there is a considerable association between ESG and specific ESG elements.

**TABLE 4:** Financial Performance of Indian Banking Institutions and ESG

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	1	972.9034012	972.9034012	61.09691269	0.000000008
Residual	31	493.6420534	15.92393721		
Total	32	1466.545455			

## Discussion

Regarding the correlation between ESG performance and financial indicators for both public and private sector banks in India, the discussion of the research paper “Impact of ESG on Bank Performance of India” provides enlightening conclusions.

According to the analysis, there is a somewhat positive correlation between ROA and ROE for public sector banks, meaning that better returns on assets are linked to higher returns on equity. This shows that these banks are capable of making profitable use of their assets to increase shareholder returns. Furthermore, ROE and ROA exhibit a significant positive association, suggesting that banks with greater returns on equity also typically have better returns on assets. This conclusion emphasises how crucial effective asset management and equity utilisation are for public sector banks to achieve overall financial performance.

The study reveals a considerable positive link between bank financial success and ESG, as determined by Tobin’s Q, in

terms of ESG performance. This suggests that banks’ financial performance tends to be stronger when their ESG performance is better. This result is consistent with the emerging understanding that incorporating ESG factors can support sustainable and resilient banking operations.

An substantial correlation between environmental performance and ROA for public sector banks is also shown by the investigation. Because environmental performance and ROA have such a significant positive link, it is anticipated that banks with better environmental practises will have higher returns on their assets. Environmental performance and ROE also show a very minor positive link. These results demonstrate the potential advantages of integrating green initiatives and sustainable practises into public sector banks’ day-to-day operations.

The study does not uncover strong evidence, however, that social and governance performance and ROA or ROE in public sector banks are related. The modest and ambiguous relationships suggest that the direct influence of social and governance variables on the financial performance of these institutions may be limited. However, it is important to note that, when taking Tobin’s Q into account, social performance and governance characteristics do show a positive link with financial performance. This suggests that in order to comprehend how ESG factors affect bank performance, a comprehensive evaluation of ESG performance, including social and governance factors, is essential.

The investigation yields different findings when the focus is shifted to private sector banks. While ROA and ROE have a slight positive association with governance and ESG performance, there is no appreciable relationship between financial performance and ESG or any of its component

aspects. This shows that the financial performance of Indian private sector banks may not be significantly impacted by ESG performance.

Tobin's Q analysis, however, demonstrates a significant link between private sector ESG, social, and governance performance and bank success. This finding highlights the significance of taking into account ESG aspects in determining overall success in these banks by showing that private sector banks with superior ESG performance are more likely to achieve greater financial performance.

## Conclusion

This research article has evaluated the relationship between Indian banks' financial performance and their environmental, social, and governance (ESG) performance. The study's findings demonstrate the strong correlation between ESG performance and bank success, especially in public sector banks. The findings show a favourable relationship between ESG performance and financial metrics including Tobin's Q, Return on Equity, and Return on Assets (ROA).

The growing acceptance of the significance of ESG integration in the banking industry is supported by the favourable association between ESG performance and financial metrics. It implies that banks with a focus on ESG aspects and sustainable business practises would likely see improved financial results over time. These results are in line with other research that demonstrated a beneficial relationship between ESG practises and financial results.

Therefore, it is crucial to remember that public and private sector banks experience different effects of ESG on financial

performance. This implies the necessity for specialised strategies and additional study to better comprehend the unique dynamics in each area. When integrating ESG elements into their operations, public sector banks may face distinct obstacles and opportunities than their private sector counterparts.

Also, the results of the research highlight the significance of regulatory frameworks and assistance for advancing ESG integration and improving bank performance. ESG laws that are more stringent have been demonstrated to improve banks' financial performance. Banks are strongly encouraged to incorporate ESG considerations into their risk management frameworks and disclosure procedures by regulatory organisations. Stakeholders, especially investors, are interested in the transparency of key ESG information, which has an effect on a bank's financial performance.

Additionally, the performance of banks is impacted by the expanding socially responsible investing (SRI) trend. Socially conscious investors are drawn to banks that offer ESG-related financial goods and services, increasing deposits and earnings. This is consistent with consumers' and investors' growing knowledge of and preference for businesses, including banks, that uphold sustainability values.

Overall, this study adds to the body of knowledge about the connection between environmental, social, and governance (ESG) aspects and financial performance in the banking industry, particularly in the Indian setting. It closes significant knowledge gaps and offers insightful information about the particular mechanisms and forces that might improve the incorporation of ESG factors into banking practises and support sustainable financial success.

Multivariate regression analysis and correlation covariance analysis were used as part of the study's quantitative research design technique. Based on the availability of ESG data and financial performance statistics, a sample of 33 Indian public and private sector banks was chosen. Utilising statistical software, secondary data from annual reports, financial statements, and sustainability reports were gathered and examined.

The results of this study lend support to the idea that ESG performance is favourably correlated with Indian bank performance, to sum up. It emphasises how crucial it is for the banking industry to take into account ESG elements in order to create long-term value, reduce risk, and improve financial performance. The findings show the possible advantages of incorporating ESG practises into banking operations and offer insightful information for policymakers, regulators, bank management, and investors. Further study is required to uncover additional variables that may affect the relationship between ESG and financial performance in the Indian banking sector, as well as to delve deeper into the specific dynamics of ESG integration in public and private sector banks.

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