

Does Sustainability Pay Off? The Relationship Between ESG Risk Rating and Financial Performance in the Banking Sector.Author: Christina Karam¹*Affiliation:*

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Abstract:

This study shows the relationship between Environmental, Social and Governance (ESG) performance and financial performance around international banks. The study uses a sample consisting of 10 banks from China and the United States. ESG performance is measured based on the Sustainalytics ESG Risk Rating, on the other hand, financial performance is measured based on the Return on Assets (ROA). To determine the relationship between these two variables we conducted a Pearson's correlation analysis, which gave us a correlation of -0.17 meaning that we have a weak negative correlation between the two variables. So, we could conclude that banks with stronger ESG performance generally tend to have higher profitability. However, this relationship is not statistically significant due to the size of the sample.

These results coincide with a lot of previous research that suggests a positive relationship between ESG and financial performance. But this relationship is not always statistically significant, especially when accounting based measures are included in a specific industry. This study provides useful information for investors, bank managers and regulators interested in understanding the effect of ESG performance on the financial performance and adds to an ongoing discussion about ESG and financial performance.

Keywords:

ESG performance, Financial performance, Return on Assets, Banking sector, ESG risk rating, Sustainable finance.

Introduction:

In the past few years, Environmental, Social, and Governance (ESG) factors have become an important area of corporate strategy and investment decisions. Due to the increasing interest in responsible investment and the involvement of stricter requirements for ESG related disclosure; investors, regulators and financial institutions have become more attentive to sustainability performance. In the banking sector, ESG performance has received particular attention because banks have a crucial role in directing the capital toward sustainable economic activities. At the same time, banks are increasingly expected to disclose and manage the social and environmental risks associated with their activities.

Despite the increased interest in ESG, its relationship with financial performance is still facing debates in finance literature. Friede, Busch, and Bassen (2015) reviewed more than 2,000 empirical studies and found that around 90% reported a non-negative relationship between ESG and corporate financial performance, with the majority of these studies finding a positive relationship. On the other hand, this perspective is not supported by all researchers. Friedman (1970), for example, argues that the main responsibility of a firm is to maximize shareholder value. From his perspective, spending resources on ESG related activities could create additional costs and potentially reduce financial returns in the short term. In the banking sector, this issue is more complex because banks operate under different accounting and regulatory systems across countries. As a result, the relationship between ESG performance and financial performance may differ from one region to another.

This study examines the relationship between ESG performance and financial performance around international banks. More specifically, it seeks to answer the following research question: Is there a statistically significant relationship between a bank's ESG Risk Rating and its Return on Assets (ROA)? To address this question, the study uses a sample of ten major international banks and analyzes the relationship between their ESG Risk Ratings and financial performance. Therefore, the study provides empirical evidence that can contribute to the broader discussion of whether stronger ESG performance is associated with better financial performance in the banking sector.

This study has both practical and theoretical relevance. From a practical perspective, the findings may be useful to investors who consider ESG factors when making investment decisions, bank managers assessing the financial effects of ESG initiatives, and regulators examining the importance of ESG disclosure requirements in the financial sector. From the theoretical perspective, it adds to the existing discussion about the relationship between the two variables by focusing only on the banking sector, which operates under specific regulatory and risk management conditions.

Literature Review:

The explanation of the relationship between ESG performance and financial performance is established through two different theoretical perspectives. Freeman (1984) introduces the stakeholder theory which states that companies can create long term value by considering the interests of different stakeholders such as communities, customers, employees and the environment, instead of focusing only on shareholders. Based on this theory, a strong ESG performance may improve financial performance by increasing the stakeholder trust, reducing operational risk, and helping firms to keep a highly competitive position over the long term. On the other hand, the agency theory, introduced by Jensen and Meckling (1976) and later linked to the ESG debate by Friedman (1970), considers managers as agents working on behalf of shareholders. From this perspective, spending the resources of the company on ESG activities could be considered as an inefficient use of capital if these resources could be returned to shareholders or invested in the main operation of the firm. Therefore, these two perspectives contribute to the continuing debate over whether ESG performance improves or negatively affects financial performance.

Till now the research findings of this issue are still mixed, even though they generally lean toward a positive role for ESG. Friede, Busch, and Bassen (2015) conducted a large meta-analysis including more than 2,000 individual studies. They found that around 90% of the studies reported a non-negative relationship between ESG and corporate financial performance, while most reported a positive relationship. These results provide more support for the expectations of the stakeholder theory than for the concern raised by the agency theory about the costs of ESG activities. One of the leading researchers on the topic consider that ESG has positive impact on equity prices (Kaspard et al., 2025 ; Kaspard et al., 2026), multiple other studies agree with that opinion (Subrahmanyam & Sarkis, 2025), Kamel et al. (2026) argues that in the era of digitalization, sustainability is more important than ever while Athari et al. (2025) examined how environmental taxes and green electricity matter for environmental quality, while other studies warned about greenwashing (Daou et al., 2025), furthermore, Subrahmanyam et al. (2024) argued that the importance of sustainability goes beyond financial performance. Yet, back to financial statements, the meta-analysis also shows that the results might be different depending on how financial performance is measured. If it is an accounting-based measure, such as ROA, it can sometimes show a weaker or less consistent relationship than market-based measures such as stock returns.

Recent research shows that this relationship can be more complex when looking specifically at the banking sector. El Khoury, Nasrallah, and Alareeni (2023) studied 46 listed banks in the Middle East, North Africa, and Turkey between 2007 and 2019, finding a non-linear relationship between ESG performance and financial performance using both accounting-based and market-based measures. The results indicate that ESG investments may improve financial performance up to a certain level, but additional ESG spending beyond that point may produce smaller benefits or even negative returns. This non-linear relationship may help explain why studies based on simple linear correlations, especially those using small or relatively similar samples, may not find a statistically significant relationship even when an underlying relationship exists.

Overall, a positive relationship between ESG and financial performance is plausible from a theoretical and empirical standpoint and is supported by a significant amount of evidence. However, the strength and statistical significance of this relationship can vary depending on the sector, sample, and measure of financial performance. The limited evidence on this relationship within the banking sector, particularly when accounting-based measures are used, provides the motivation for the present study.

Methodology:

This study implements a quantitative, cross-sectional and correlational research design in order to examine the relationship between corporate ESG performance and financial performance in the banking sector.

It explores ten large international banks chosen using a purposive sampling approach. The decision of which bank to choose is based on whether both ESG and financial information were available for these banks from secondary data that were already publicly accessible. In order to allow this study to consider differences in regulatory and accounting systems, the study focuses on banks from U.S. and China. ESG information was taken from Morningstar's Sustainalytics ESG Risk Rating, while the financial information was obtained from the banks' annual and interim reports as well as financial data platforms.

In this research, the independent variable is the ESG Risk Rating, which ranges from 0 to 100. A lower score reflects lower ESG risk and indicates better ESG performance. The dependent variable is Return on Assets (ROA), used to measure financial performance. For two banks included in the sample, HSBC Holdings and Goldman Sachs, ROA was not directly reported. Therefore, ROA was calculated using the reported net income divided by total assets.

Pearson's (Karl Pearson) correlation coefficient (r) was used to examine the relationship between the ESG Risk Rating and ROA. The coefficient was calculated in Microsoft Excel using the CORREL function.

Results:

This section presents the results obtained from the sample and the variables discussed in the Methodology section. Table 1 shows the ESG Risk Rating and ROA values for each bank involved in this study.

Table 1: ESG Risk Rating and Return on Assets (ROA) for sample banks.

Bank	ESG Risk Rating (Sustainalytics)	Return on Assets (%)
HSBC Holdings	23.1	0.75
Morgan Stanley	24.8	1.10
Goldman Sachs	25.2	1.10
Bank of America	25.5	0.90
China Construction Bank	26.0	0.85
JPMorgan Chase	27.3	1.30
Citigroup	29.2	0.60
ICBC	29.5	0.78
Agricultural Bank of China	32.4	0.67
Wells Fargo	36.2	1.00

Note: Lower ESG Risk Rating indicates stronger ESG performance.

For the HSBC and Goldman Sachs banks the ROA was not publicly available, so the ROA figures were calculated from reported net income and total assets.

To examine this relationship, a Pearson correlation analysis was conducted, which showed a weak negative correlation between the two variables ($r = -0.17$). This indicates that banks with lower ESG risk (stronger ESG performance) tend to exhibit a marginally higher profitability. However, it is important to mention that the small sample size of 10 banks does not provide sufficient evidence to confidently generalize the results on a broader population; therefore, the relationship is not statistically significant at the conventional significance level. The figure below shows a scatter plot illustrating the relationship between ESG Risk Rating and ROA across the sample.

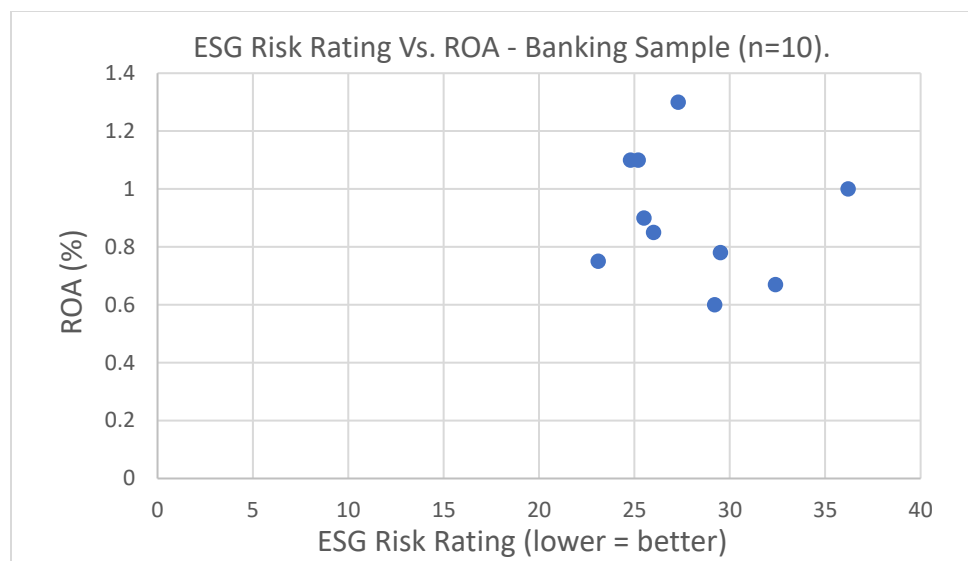


Figure 1: Scatter Plot of ESG Risk Rating vs. ROA – Banking Sample (n=10).

Therefore, an initial empirical basis is provided for addressing the research question which is whether a stronger ESG performance has an association with the improvement of financial performance in the banking sector .

Discussion and Conclusion:

This study investigated the relationship between ESG performance and financial performance using a sample of ten major international banks. The analysis used the Sustainalytics ESG Risk Rating and Return on Assets as the main variables. The results showed a weak negative correlation between ESG Risk Rating and ROA ($r=-0.17$), indicating that banks with stronger ESG performance tend to have slightly higher profitability. However, the relationship was not statistically significant at conventional levels.

From a theoretical perspective, the results coincided with part of the existing literature, which suggests that ESG performance has a positive relationship with financial performance, even though this relationship is not always statistically significant. This is relevant when accounting-based measures are used rather than market-based measures. Therefore, the relationship between ESG and financial performance may vary depending on the performance measure selected, which is an important point for future theoretical research in this area. From a practical perspective, the results show that banks with strong ESG performance (lower ESG Risk Rating) do not appear to be financially disadvantaged compared with their peers. This may provide reassurance to bank managers who are considering additional investment in their ESG initiatives. As for investors, the findings suggest that ESG Risk Rating by itself may not be a strong predictor of short-term profitability in the banking sector. Therefore, ESG factors may be better considered together with traditional financial analysis rather than used as a replacement for it.

Several limitations of this study should be considered. First, the sample is relatively small and includes only ten banks. This reduces the statistical power of the analysis and limits the extent to which the findings can be generalized to the wider banking sector. Second, the banks in the sample operate in different regulatory and accounting environments, particularly in the United States and China. These differences may influence the comparability of both ESG risk assessments and reported financial information. Third, the ESG and financial data did not all come from the same reporting period. Some figures represent full-year results, while others are based on interim or trailing twelve-month data, creating some inconsistency in the timing of the data. Fourth, a directly reported ROA figure was unavailable for two banks in the sample, HSBC Holdings and Goldman Sachs. As a result, ROA was estimated by dividing net income by total assets. This may create some measurement approximation compared with the directly reported figures available for the other banks. Finally, the study uses only one ESG rating provider, Sustainalytics, and one financial performance measure, ROA. Since different ESG rating agencies can provide different assessments of the same company, the findings should therefore be understood as specific to the methodology and data sources used in this study rather than as a conclusion that can be fully generalized.

Future research could extend these findings in several ways. Using a larger sample of banks would increase the statistical power of the analysis and provide a stronger basis for generalizing the results. Researchers could also include several ESG rating providers, such as MSCI or S&P Global, in addition to Sustainalytics. This would help determine whether the findings are specific to one rating methodology or are also observed across different providers. Future studies could further investigate other measures of financial performance, including Return on Equity and stock market returns, to examine whether the strength of the ESG-performance relationship changes depending on the measure used. Finally, a longitudinal approach that follows the same banks over several years could help determine whether the relationship between ESG and financial performance becomes stronger, weaker, or remains stable over time.

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