Book review: Sustainable finance and ESG; risk, management, regulations and implications for financial institutions

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Sustainable development has become a crucial topic in the 21st century due to climate change and environmental degradation, which has led to efforts to implement sustainable development initiated by the Sustainable Development Goals (SDGs) and the Paris Agreement. This has also become an important subject due to the increasing global awareness of environmental, social and financial aspects (Riegler, 2023). Remarkably, the banking sector, as a financial institution, is consistently required to develop standards and practices by integrating sustainability criteria into their business strategies under the comprehensive global development framework (Kashi and Shah, 2023). Currently, the demand for sustainable business practices is rapidly increasing, and implementing sustainable banking strategies can become a competitive advantage to enhance customer loyalty (Mishra and Sant, 2023). However, approximately 60% of banks have not effectively implemented climate risk stress testing, and most financial institutions are still in the early stages of climate risk framework development (European Central Bank, 2022). On the other hand, this can substantially affect the reputation of banks (Gutiérrez-Ponce and Wibowo, 2023). Changing business practices through strategies more oriented towards environmental, social and corporate governance (ESG) factors and offering sustainable products is one way to achieve sustainable finance. ESG for banks represents an investment in intangible assets, which may not yield quick profits in the short term but can become a critical foundation for sustainable bank operations and development in the medium and long term (Ji *et al.*, 2023). This presents an exciting challenge in the widespread implementation of ESG policies due to

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the lack of regulatory awareness of climate change risks, leading to bank management's slow adoption of ESG-based business models (Galletta *et al.*, 2022).

This book provides readers with perspectives on the impact of sustainable finance, including environmental, social and governance aspects, and how banking business strategies are changing to meet the demands of ESG implementation by regulators and investors. Considering that much still needs to be done in this direction to fulfill social responsibilities, address climate change risks, maintain banking loyalty and reputation, and even serve as a strategic component of long-term success. The book consists of eight exciting discussion sections that offer new insights into developing sustainable business models for financial institutions. In Chapter 1 by Cornée *et al.*, the authors explain the importance of the social banking business model, which represents a unique niche alternative and a more sustainable banking model. The financial sector has witnessed a new mindset concerning social, environmental and ethical values under "social banking." The authors distinguish social banks from conventional banks based on several dimensions, such as specific target customers, alternative risk management to address asymmetric information and stakeholder participation. These concepts are not merely theoretical but practical principles that give rise to the theory of the social banking business model. ESG is also a strategic component in achieving long-term success for financial institutions. Thus, in Chapter 2, Weber *et al.* conduct a literature review approach to explore ESG issues, including how ESG criteria influence commercial loans, through an analysis of financial aspects integrated with ESG in various banking products and services. The results indicate that considering ESG criteria is necessary due to their positive effects on financial risks, leading to better sustainability and improved financial performance to meet market demands. However, ESG criteria are not yet standardized, and the quality of indicators often proves difficult to evaluate. Integrating ESG into business strategies will also face many challenges in the future.

In the same case, financial institutions face market demands from investors and regulators to integrate the ESG framework that influences customer loyalty and satisfaction through implementing corporate social responsibility (CSR). In Chapter 3, Kartonis and Grigoroudis conduct a literature review comprising 24 articles from 2009 to 2021 related to CSR in banking and mutual funds. They apply various methodological approaches, such as structural equation modeling, partial least square (PLS) regression, conceptual model development, survey research strategies, and exploratory and confirmatory factor analysis. The most recent study by Ahmad *et al.* utilizes the mediating role of customer satisfaction and the effect of corporate image with a PLS-structural equation modelling (SEM) model. The findings explain that CSR positively affects customer satisfaction but has a non-significant relationship with customer loyalty. Furthermore, the mediating effect of customer satisfaction stimulates customer loyalty. Overall, the previous literature discussion, which mainly focused on CSR, lacked studies exploring the direct connection between CSR and customer satisfaction and loyalty. In this chapter, ten papers investigate the relationship between CSR and customer satisfaction, while 12 papers evaluate the relationship between CSR and customer loyalty. CSR initiatives have a positive effect on customer satisfaction and loyalty. Interestingly, this research also discusses various dimensions of CSR based on previous studies to observe the development patterns of CSR that contribute to the innovation of new CSR activity models, which will enhance customer trust in the banking sector.

The concept of social responsibility has recently emerged in the context of Social Responsibility Investment (SRI), with many investors now considering their assets to be managed with a focus on ESG scores. According to the US Sustainable and Impact Investing Trends data concerning assets under management, the consideration of social factors lags behind environmental and governance criteria. However, the social criteria significantly increased, reaching $16.1tn in 2020 from $10tn in 2018, representing a 49% rise. Nonetheless, the increase in the environmental aspect was even more substantial, rising by 57% from

$10tn in 2018 to $16.0tn. Further research in Chapter 4, conducted by Doumpos *et al.*, indicates the absence of a clear definition of SRI. Investors tend to reward companies that display positive social behavior, but comprehensive information about SRI for investors is still lacking. To address this, the study compiles a comprehensive list of indicators and criteria that serve as a methodological basis for objectively and measurably assessing ESG performance and selecting SRI investments. These indicators encompass environmental aspects (emissions, resource utilization, innovation), social aspects (labor, human rights, product responsibility) and corporate governance (management, shareholders, CSR strategy). Moreover, the research presents case studies on socially and environmentally oriented fund management, divided into four discussions: characteristics and performance of socially responsible mutual funds, investor attitudes towards SRI funds and the optimization of SRI mutual fund portfolios. These discussions shed light on why investors choose SRI, how SRI performance compares to conventional investment performance and the projected returns of SRI investments.

The book then elaborates on the interaction between borrowers and banks through assessing ESG content to access financial resources in Chapter 5 by Cheng and Hasan. The authors explicitly explain the activities, terms and conditions that influence banking decisions and evaluations regarding relevant institutions. They state that besides provisions concerning collateral, interest rates, maturity agreements, and the financial and operational performance of the institution as primary considerations, the quality of handling ESG issues must also be considered. Not just theoretically, the authors then provide empirical evidence regarding this matter by using ESG quality as a basis for assessment. Using data from Thomson Reuters' LPC DealScan and MSCI, the authors analyze banking institutions in the US and ESG as borrowers through ordinary least square (OLS) regressions. The research results demonstrate that ESG can influence banking decisions positively and significantly, increasing the number of loans. In this chapter, in creating sustainable finance and comprehensively promoting environmental issues, the awareness of fund users, primarily firms, to enhance their ESG quality is crucial.

The analysis of ESG quality is further explained in depth by Gaganis *et al.* in Chapter 6. The authors believe that assessing companies' ESG performance can be a basis for analyzing risks and formulating mitigations. Gaganis explores previous literature and market analysis to substantiate this theory. The theories of The Case of Standard & Poor's (S&P), The Case of Fitch and The Case of Moody's are developed as credit analysis assessments with credit reference agencies (CRAs). Collectively, they conclude that ESG factors can enhance creditworthiness, reduce risks and assist banks in monitoring the condition of companies. Hence, references concerning ESG data need to be disclosed transparently and follow specific standards that describe the actual state of affairs. In this chapter, the author presents the importance of ESG in promoting sustainable finance in a straightforward yet comprehensive manner, allowing readers to truly understand its significance.

Moving on to Chapter 7, this book delves into a more specific perspective of politics and policies that support sustainable finance and raise awareness of ESG issues. D'Orazio analyses policies related to green markets, green taxonomies and sustainable finance in G20 countries, which significantly contribute to global CO_2 emissions. The research findings reveal that there are still limited policies pro-transition to low-carbon and the use of funds in environmentally-friendly sectors. In addition, the author also found that there is no standardized collection and reporting of ESG data so that policy makers are unable to formulate targeted regulations. Through this research, readers will realize that the role of government can create harmonization finance norms for enterprises, focusing on profit maximization and conserving environmental values, particularly regarding carbon emissions.

Continuing the discussion on the importance of formulating sustainable financial policies, in the final chapter, D'Orazio provides readers with an understanding of regulations from the

banks' perspective as fund providers. The researcher finds that not all countries have banking systems with regulations ready to achieve the goals of the Paris Agreement in addressing climate change. Interestingly, significant countries like the United States, Russia and Saudi Arabia fall into the category of countries with below-average regulations. On the other hand, Indonesia, South Korea, China and Australia were found to have high scores on the climate-related financial policy index (CRFPI). The analysis by D'Orazio concludes que globally, only 38 % of banking regulations promote green and climate finance. Although environmental issues are receiving increasing attention, this chapter reveals that government and banking regulations are not fully prepared. Therefore, in the future, monetary policy constructs must be well-integrated and comprehensive to collaborate the roles of various stakeholders, which must be supported by up-to-date and transparent data readiness.

Overall, this book is a suitable choice for understanding the mission of sustainability in the financial sector. The author endeavors to provide a comprehensive explanation of this topic, where green financing is defined as a tool to provide financial support for environmentally friendly projects, with environmental protection as the primary objective. This includes financing for resources, carbon and operational funding (Zhang, 2023). Indeed, by increasing the awareness of various stakeholders regarding the importance of achieving social and environmental balance through the pivotal role of the financial sector, better harmonization can be created without neglecting its economic aspects. Furthermore, the highly systematic arrangement of topics facilitates a comprehensive understanding of the purpose of this book. It begins with an introduction to the concept of conventional banking and its comparison with socially-oriented banking systems, then delves into corporate values and social responsibility, culminating in ESG issues and the role of government and banking regulations. The entirety of the topics builds a cohesive, comprehensible discussion, providing theoretical approaches supplemented by empirical evidence from financial systems worldwide. Through this book, readers will realize that ESG is a crucial standard for evaluating a company's comprehensive level and a vital tool for implementing carbon neutrality strategies and promoting green finance, garnering widespread attention and concern from the entire society.

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