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ESG and bank profitability: the moderating role of country sustainability in developing and developed economies

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Abstract: This article analyses how country sustainability determines the effects of Environmental, Social and Governance (ESG) scores on bank profitability in developing and developed economies. Furthermore, we distinguish the effects across different country sustainability dimensions (social capital, resource intensity, governance framework, intellectual capital and natural capital). Using a sample of 166 banks from 42 countries during 2018-2023 (856 observations), we find that better ESG scores have negative effects on profitability in developing countries with low or moderate sustainability levels. As country sustainability increases, this negative effect is reduced and ends up not being significant. Besides, if country sustainability reaches a high level, the ESG-profitability relationship is reversed and superior ESG ratings lead to higher financial returns. These global results are driven by the social capital and resource intensity dimensions of country sustainability. Regarding developed economies, the effects of country sustainability on the ESG-profitability relationship are less beneficial than in developing economies in all dimensions except for the natural capital one. Superior natural capital scores in developed countries attenuate or even eliminate the negative effects of ESG improvements on financial performance whereas in developing regions natural capital has not a significant impact on the ESG-profitability relationship.

Keywords: country sustainability; ESG; bank profitability; developing countries, developed countries

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