Facultad de Ciencias Económicas y Empresariales
ICADE

CAN GROWTH AND PROFITABILITY COEXIST WITH ESG?: SUSTAINABLE BANKING IN SPAIN (2015-2022)

Author: Lucia Ors Castillejos
Director: Dr. Natalia Cassinello Plaza

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ABSTRACT

This study explores the coexistence of growth and profitability with the incorporation of Environmental, Social, and Governance practices in the Spanish banking sector from 2015 to 2022. Although the banking sector in Spain has faced significant challenges due to the long period of low interest rates, the study demonstrates that the banks listed in the IBEX 35, particularly BBVA and Santander, have achieved exceptional growth and profitability while implementing ESG strategies. This study demonstrates that even in a rough economic situation, implementing sustainable strategies and committing to ESG standards are compatible with financial profitability. The emergence of Spanish ESG regulation has been proven to be a vital driver to this accomplishment and demonstrates the banks' dedication and effort to implement change. Looking ahead, in order for banks to remain resilient and competitive in a global economy that values sustainability, it is essential for them to adapt and improve their strategy continuously.

Keywords: Sustainable banking, ESG, growth and profitability, ESG regulation, Spanish banking sector.

RESUMEN

Este estudio explora la coexistencia de crecimiento y rentabilidad con la incorporación de prácticas ambientales, sociales y de gobernanza en el sector bancario español de 2015 a 2022. Aunque el sector bancario en España se ha enfrentado a importantes desafíos debido al largo período de bajas tasas de interés, el estudio demuestra que los bancos que cotizan en el IBEX 35, particularmente BBVA y Santander, han logrado un crecimiento y una rentabilidad excepcionales, al mismo tiempo que implementan estrategias ESG. Este estudio demuestra que incluso en una situación económica difícil, implementar estrategias sostenibles y comprometerse con los estándares ESG son compatibles con la rentabilidad financiera. Se ha demostrado que la regulación ESG española es un impulsor vital para este logro y demuestra la dedicación y el esfuerzo de los bancos para implementar cambios. De cara al futuro, para que los bancos sigan siendo resilientes y competitivos en una economía global que valora la sostenibilidad, es esencial que adapten y mejoren continuamente su estrategia.

Palabras clave: Banca sostenible, ESG, crecimiento y rentabilidad, regulación ESG, sector bancario español

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ABBREVIATIONS

- ESG: Environmental, Social, Governance
- ROA: Return on Assets
- ROE: Return on Equity
- CAGR: Compounded Annual Growth Rate
- SRI: Socially Responsible Investing
- GRI: Global Reporting Initiative
- NFRD: Non-Financial Reporting Directive
- SRD II: Second Shareholder Rights Directive
- SFDR: Sustainable Finance Disclosure Regulation

CHAPTER I: INTRODUCTION

1.1 Justification

In the current period, “consumers, investors, and business leaders alike are becoming more committed to climate action, ethical labor and manufacturing practices, and other causes important to them” (*ESG in banking: The future of the financial sector* 2020). For businesses and financial institutions, the incorporation of environmental, social, and governance (ESG) principles has evolved to become a business imperative, not just a moral obligation. With the implementation of new regulations, and new moral principles, businesses are now motivated to promote an inclusive and green economy. According to recent studies, financial institutions that incorporate ESG factors improve their brand reputation, customer loyalty, competitive advantage and reduce their risk profile (*ESG in banking: The future of the financial sector* 2020). The existence of new and old regulatory frameworks demonstrates a widespread agreement on incorporating sustainability into financial services in order to attain a more sustainable economic trajectory (Oni, 2016).

The European Union is recognized for its high interest in regulating financial sustainability, and is seeking to harmonize further the non-financial reporting expectations among its member countries (AI, 2023). The EU has work plans for 2024 that place a strong emphasis on projects related to sustainable finance, digital finance packages, and cross-sector challenges (BBVA, 2024). As part of the legislative framework for sustainable finance, EU legislators are aligning non-financial reporting requirements and setting transparency standards through the Disclosure Regulation (European Union Law, 2023). This legislation is supplemented by additional regulations such as the EU Taxonomy, the Climate Transition legislation, and reference indexes that are in line with the Paris Agreements. Moreover, the United Nations 2030 Agenda for Sustainable Development links the Sustainable Development Goals and the action framework of the European Union, guaranteeing that all activities and initiatives include these objectives from the beginning (Reglamento UE, 2020). Overall, the European Union has placed great emphasis on financial sustainability and continues to implement regulations and efforts for its enactment and achievement.

The regulations implemented by the European Union, as well as worldwide, has had a substantial influence on the operational practices of banks. Consequently, there has been an increasing interest in assessing the environmental performance, social responsibility, and corporate governance in the banking industry (Bătae et al., 2020). Studies conducted by Buallay (2019) and Azmi et al., (2021) have provided evidence of a strong and positive correlation between environmental, social, and governance (ESG) aspects and the operational, financial, and market performance of banks. Additionally, it has been determined that a bank's risk can be reduced, and financial stability can be improved by achieving good ESG performance, by enhancing risk management and increasing operational efficiency (Tóth et al., 2021). Other studies proved the contrary, Bătae et al., 2020 discovered that an improvement in a bank's corporate governance system had a detrimental impact on its financial performance, and Amzi et al., 2021 observed a non-linear correlation between ESG activities and bank value. Moreover, El Khoury et al. (2023) conducted research indicating that the favorable impacts of ESG investment in banks may reach their highest point before gradually diminishing. Notwithstanding, studies have also proven that the outcomes may differ based on geographical and macroeconomic factors (Bătae et al., 2020)

Collectively, these studies have offered different perspectives on the impact of incorporating ESG factors into the financial performance and growth of banks. While some studies indicate that engaging in ESG activities may initially reduce profitability due to an increase in operating expenses (Yuen et al., 2022), other research suggests that these efforts can improve cashflow and efficiency (Amzi et al., 2021). The different results of the studies can be due to the difference in methodological techniques, variances in geographical locations, and macroeconomic parameters. Within this particular setting, conducting an analysis that specifically centers on publicly listed Spanish banks offers a captivating opportunity for further investigation. Hence, our study aims to thoroughly investigate the impact of ESG factors on Spanish bank's profitability and growth by analyzing and comparing the real values of all the Spanish listed banks in the IBEX 35, and also identify the Spanish banking institutions that are at the forefront of integrating "green" initiatives.

1.2 Objective

The objective of this project is to determine whether it is possible for listed Spanish banks to simultaneously achieve revenue and profitable growth while integrating Environmental, Social, and Governance (ESG) principles within their operational framework from years 2015 to 2022.

1.3 Methodology

The methodology of the study consists of three main phases:

1. Search and Review of Preliminary Information

Firstly, a comprehensive information search was conducted using a combination of professional and academic information sources. These sources were gathered from Google Scholar, newspapers, and annual bank reports. The purpose of this stage is to gather both qualitative and quantitative information on the economic environment of Spain, ESG and its regulations, the financial ratio of banks, and the relationship between ESG, profitability, and growth.

2. Performance Data Collection

Subsequently, performance data on ESG metrics, revenue turnover, and profitability for all listed Spanish banks were derived from the reliable database of Bloomberg. These data sources offer up-to-date and reliable figures, providing a solid foundation to analyze the financial and sustainable performance of the banking institutions. The listed Spanish banks analyzed were Bankinter, BBVA, Caixabank, Sabadell, Santander, and Unicaja.

3. Strategy Analysis

In the final phase, a strategy analysis will be conducted between the bank with the highest performance in revenue growth, profitability, and ESG integration and the bank with the lowest performance. The ESG strategy of each bank will be analyzed through the use of resources published on their official website, including their annual ESG report, as well as other relevant case studies addressing this subject matter. This section will provide insight into the strategies that allow the banks to navigate the intersection of financial growth and sustainability successfully.

1.4 Structure

This study is structured in three main blocks, which are in first place contextualization, in second place a quantitative analysis of the Spanish listed banks, and in third place, a qualitative analysis.

In the first block, the economic environment of Spain was analyzed, examining how changes in the European Central Bank policy and extraordinary events like COVID-19 impacted the banks. Also, this block contains a historical and conceptual overview of ESG elements, as well as a full analysis of the ESG regulations that are applied to the Spanish banking sector. Overall, this section establishes the theoretical and legal framework to comprehend how sustainability has become a crucial element for growth and profitability in the banking sector.

The next section includes an analysis of the Spanish-listed banks on the IBEX 35 regarding variables such as growth (revenue and market capitalization), profitability (ROE and ROA), and sustainability (ESG disclosure score) during the time period between 2015 and 2022. By collecting data from reliable sources such as Bloomberg and calculating the Compound Annual Growth Rate as well as the average for each variable, the banks that outperformed in each variable were identified. The comparative analysis shows the evolution of banks in financial and sustainable aspects, allowing them to be ranked based on their performance in these crucial areas. This analysis highlights which banks have achieved a balance between growth, profitability, and sustainability, as well as banks that have achieved a good performance in only two or one of these factors.

The final section demonstrates the previously described concepts by examining two concrete cases: Santander Bank as a successful example of integrating growth, profitability, and ESG factors ("Triple Play"), and Unicaja as a statistically less effective case. This study examines the tactics and strategies of each bank that have allowed them to lead to success in the banking industry, as well as the issues that can occur from inadequate adaptation to market demands and sustainability requirements. This block highlights the differences between banks and stresses the significance of a coherent strategy that balances growth and sustainability.

Overall, these sections offer an in-depth perspective on the Spanish banking sector, illustrating the importance of adjusting to economic changes and the importance of incorporating sustainable methods for a "Triple Play" success. This study contributes valuable insights for financial professionals interested in sustainable growth strategies.

CHAPTER 2: CONTEXTUALIZATION

In this section, we will analyze Spain's economic landscape, more specifically, its monetary policy, to evaluate how it affected the profitability of the Spanish banks during the years of 2015 to 2022. We also introduce the Environmental, Social, and Governance (ESG) factors, its origin, and the impact it has had on the banking sector through the introduction and continuous evolution of its regulatory framework. Lastly, we examine the impact that ESG can have on banking profitability through empirical studies to understand if there's a relationship between both factors.

2.1 Economic Environment in Spain: Monetary Policy

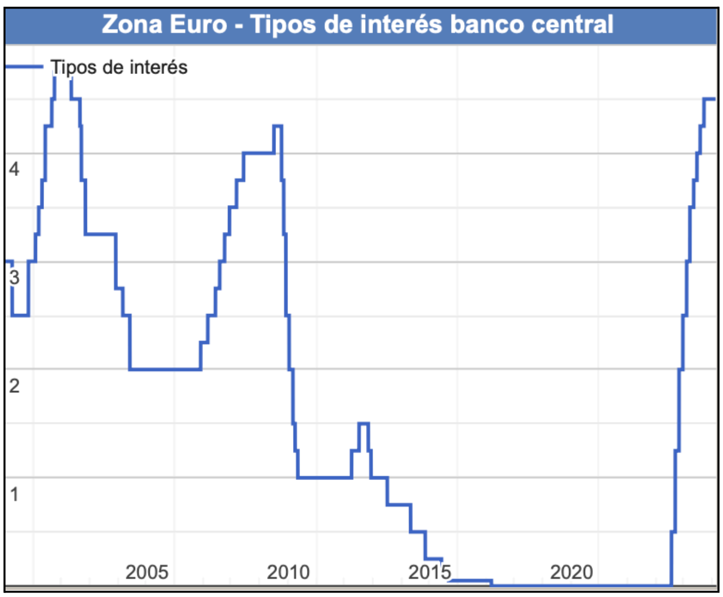
During the analyzed period, from 2015 to 2022, the economic conditions of the euro region were characterized by a sequence of difficulties and improvements, mainly caused by the strategies of the European Central Bank in response to different macroeconomic conditions.

During the first period, 2015 to 2021, the ECB, led by Mario Draghi and later Christine Lagarde, implemented historically low interest rates and asset purchase programs, referred to as quantitative easing, to inject liquidity into the financial system (Rios y Chillón, 2016). These actions were made with the purpose of boosting economic growth, promoting investment and consumption, and addressing ongoing deflationary pressures after the 2008 global financial crisis and the European debt crisis. In the case of the European area, this was exemplified by the ECB's monetary instruments, including the ECB Interest Rate (%), the Deposit Rate (%), and the Lending Facility Rate (%).

The main interest rate that the ECB sets, which represents the cost of borrowing for banks in the euro region, is referred to as the ECB Interest Rate (%). In order to facilitate access to credit, this rate stayed at historically low levels during the period of 2015 to 2021, frequently approaching zero or even becoming negative. Likewise, the interest rates on the deposit facility remained low to incentivize banks to increase lending at a reduced cost rather than retaining capital in the ECB (Penty & Montijano, 2023). And the lending facility rate also remained low to ensure that banks had access to short-term financing. These rates, staying close to zero or negative, affected the overall interest rate climate in the Spanish banking industry (*Tipos del BCE - banco central europeo 2023*).

Figure 1:

Central bank interest rates from 2000 to 2022



Source: T*ipos del BCE - banco central europeo 2023*

The Covid-19 pandemic in 2020 also worsened pre-existing economic difficulties, causing an unexpected economic recession, causing a -6.34% decrease in Eurozone GDP (Mira Linares, 2023). The ECB responded by implementing an even more expansionary monetary policy, where interest rates were kept low, and asset purchase programs were further increased to inject more liquidity into the markets (Aguilar et al, 2020).

Lastly, in late 2021 to early 2022, inflation increased notably due to supply shortages and rising energy prices, aggravated by the Russian invasion of Ukraine. Therefore, the ECB increased interest rates to address increasing inflation switching from its previous expansionary monetary policies. The interest rate increase seeks to reduce demand by raising the cost of credit and protecting against the threat of a continuous rise in inflation expectations (Mira Linares, 2023).

2.1.1 Low-interest environment impact on banks

The long period of low interest rates affected the Spanish banks in various ways. Firstly, it allowed firms and individuals to borrow money at cheaper rates, which promoted credit growth and boosted the economy. Therefore, the demand for banking goods and services increased, and people borrowed for a variety of reasons, including consumer spending, company investment, and property buying (Penty & Montijano, 2023). Additionally, reducing borrowing costs allowed banks to refinance their debt on favorable terms, which relieved the financial strain and strengthened their liquidity position.

The interest rate environment did, however, pose serious obstacles to the profitability of Spanish banks. For instance, the net interest margins, which represent the difference between interest paid on deposits and interest received from loans, decreased significantly. Banks had challenges in maintaining their profit levels due to decreased income from traditional lending and investment activity, this posed a difficulty for banks to improve their "green" strategies (Hanzlík & Teplý, 2022). Additionally, the extended period of low interest rates also heightened the possibility of asset bubbles, in the real estate sector, for example, which threatened financial stability on a systemic level (Kuttner, 2012).

As a result, banks increased their service fees and created new financial products in order to try to diversify their income (Silva et al., 2023). Some examples of the new financial products created include mobile banking apps, which let consumers conduct financial transactions from their mobile devices and lower the need for physical branches and the expenses that come with it, and a new or a wider range of financial advising services such as wealth management and mergers and acquisitions, allowing banks to make money from fees and commissions. Stricter regulatory requirements also put more pressure on profitability, which caused banks to adopt operational efficiency strategies, including digitalizing financial services and streamlining their branch network. Despite these initiatives, rigorous risk management was needed to prevent an increase in unsustainable debt levels due to the rise in credit (Aguado, 2023).

As mentioned, the Spanish banks included various tactics to adjust to the long period of low-interest rates in order to maintain expansion and lessen the impact on profitability. These strategies included cost reduction measures, digital transformation to improve operation efficiency, cutting costs, and diversifying revenue sources through fee-based services. For example, in order to cut costs, banks closed branches and reduced their staff; specifically, the number of branches decreased by an average of 40%, and staff levels were reduced by 30% (Hernández de Cos, 2019).

2.1.2 Increase interest environment impact on banks

On the other hand, the ECB's reference interest rate in Spain grew to an astonishing 4.5% in 2022 (*Tipos del BCE - banco central europeo 2023*), and it has had a substantial impact on some of the bank's activities as well. Firstly, Spanish banks saw an increase in net interest income due to the higher lending rates. The bank's profits increased as a result of the growth in net interest revenue, which improved its financial performance (Busch & Memmel, 2017). Additionally, this readjustment allowed banks to change the prices of their products, improving the value of savings programs to attract deposits at a reasonable cost.

On the downside, higher borrowing costs also put a strain on financial borrowers. Loan growth and asset quality were highly impacted due to the elevated servicing costs on loans, and banks started to see a shift in loan demand and creditworthiness (Izquierdo, 2023).

To summarize, the Spanish banking sector lived through a decade of historically low-interest rates and experienced an increase in 2022. Banks had to adjust to a situation where the revenue of their traditional financial products was decreasing, and they had to adjust to the pressure it was having on their interest margins. In order to counteract these consequences, they undertook measures such as income diversification and operational efficiency. Although the recent rise in interest rates improved the bank's net interest income, it also presented difficulties for borrowers. Overall, the Spanish banking sector has lived through uncertain environments; they've had to reduce their financial income margins, which has made it harder to be more "green," making them find income in other ways. They’ve had to continuously implement actions to keep growing and serve their clients.

2. 2 ESG Origin: Concept

This section explores the origin and development of Environmental, Social, and Governance principles in today’s business world. It highlights the evolution of how ESG started to be recognized, and how it evolved to be an aspect that must be regulated. The concept and principles of ESG have grown to become a powerful force in the world of business, and although this term emerged in the 2000s, the underlying ideas extend much further back. Throughout history, pivotal moments in the ESG evolution have taken place that deserve to be highlighted.

The rise of environmental consciousness appeared in the 1970s and 1980s, which marked the first steps towards what is now recognized as ESG. During these years, companies started to feel compelled to reveal their environmental impact as they began to worry about pollution, resource depletion, and other negative environmental effects (Carbon, 2023). Then, Socially Responsible Investing (SRI) and the establishment of the Global Reporting Initiative (GRI) in the 1990s demonstrated a shift in investors’ priorities. With the SRI, investors started to take into account the social and ethical behavior of the companies they were investing in; their priorities started to shift, influencing companies' reporting and conduct. The GRI became a very well-known framework to report on the social, environmental, and economic impacts, and today it is a widely adopted reporting method (Carbon, 2023). This environmental awareness approach was further strengthened by The United Nations Framework Convention on Climate Change in 1992 and the United Nations Global Impact in 1999. The first one had the goal of preventing human tampering with the climate system, and the United Nations Global Impact was a program that urged companies to “commit to ten principles covering human rights, labor, environment, and anti-corruption” and to submit annual reports on their environmental initiatives (Carbon, 2023).

In 2004, the first mainstream mention of ESG appeared in a United Nations study named “Who Cares Wins.” This paper strongly advocated for the long-term adoption of ESG by stakeholders (including managers, investors, analysts, brokers, etc) (Byrne, 2023). The Kyoto Protocol was implemented in 2005, were 192 nations agreed to set specific targets to reduce greenhouse emissions (Naciones Unidas, 2022), and this was followed by the passage of the Paris Agreement and the UN Sustainable Development Goals (SDGs) in 2015, with the goal of establishing a global framework for social and environmental reporting. Businesses globally have started to coordinate themselves to meet these efforts. Notwithstanding, many countries made environmental reporting mandatory; the European Union required large companies to reveal non-financial information, and China established ESG disclosure requirements. The European Union also established the European Green Deal in 2019 with the goal of becoming the first continent to be carbon neutral by 2050 (Carbon, 2023).

Overall, there have been significant milestones that have helped the ESG framework develop to where it is today. The acceptance of the ESG principles has been due to the increasing awareness of the impact companies have on the environment and society. Thanks to worldwide initiatives and shifting investor preferences, corporations are creating a more responsible and sustainable global economy. With these initiatives, the ESG principles have become a framework that most companies and stakeholders follow, and according to Bloomberg data from 2023, approximately $30 trillion has been invested globally in ESG funds, displaying the commitment to improve and strive for a better world (Carbon, 2023).

2.3 ESG Factors: Environmental, Social and Governance

ESG is an acronym that stands for Environmental, Social, and Governance. It "refers to a collection of corporate performance evaluation criteria that assesses the robustness of a company's governance mechanisms and its ability to effectively manage its environmental and social impacts" (*Definition of environmental, social and governance (ESG) - gartner ...*). Today, it is a crucial component of corporate evaluations.

2.3.1 Environmental

The environmental pillar takes into account the indirect and direct impact a company's activities can have on the environment (Dragomir, 2020). This includes an organization's ecological footprint, greenhouse emissions, and water and air pollution. Additionally, the company is also evaluated on its resource management, closely examining how materials are used and how committed the company is to reusing and recycling (*#1 what is ESG?* 2022). The recently enacted "Climate Change and Energy Transition Law" by the Congress of Deputies of Spain in May 2021 is a noteworthy legislative development that displays the importance of environmental responsibility in the business world. It highlights the urgency of adopting methods that reduce climate change and facilitate a shift towards renewable energy (*Agencia Estatal Boletín Oficial del Estado*).

Incorporating environmental factors into traditional financing decisions has proved to be beneficial not only for increasing environmental consciousness but to acquire other operational and satisfaction benefits. For example, implementing environmental factors into daily operations can improve resource availability, employee satisfaction, and customer willingness to buy a product (Bush, 2016). Furthermore, it allows the company to increase operational efficiency, which can result in long-term cost savings (Vitasek, 2022).

2.3.2 Social

The social pillar assesses the company's relationship with the community and its own employees. It focuses on promoting employment equity, fostering inclusion, enhancing employee well-being, and creating a good impact on local communities (Semet, 2020). Business practices that prioritize fair treatment, diversity, and worker safety are crucial indications of successful social performance.

Historical and social events have had a substantial impact on the ideas that the social pillar encompasses today. From the enactment of the Universal Declaration of Human Rights (UDHR), which promoted a global commitment to human rights principles, to social movements such as the American Civil Rights Movement and the Women's Rights Movement in the 1950s and 60s; companies are expected to make constructive contributions to society by supporting efforts such as gender equality and non-discrimination. Additionally, the work of Howard R. Bowen in "Social Responsibilities of the Businesses" has set a standard for businesses to focus not only on profit-making but the impact of the company on the employees and society. The evolution of these historical events has contributed to the creation and development of the social pillar, highlighting the significance of ethical, equitable, and socially responsible practices.

2.3.3 Governance

The third pillar of ESG, governmental, focuses on the management and control of the activities of a firm, including board structure, executive compensation policies, and compliance with the law. Effective governance guarantees transparency and accountability within the company, which is crucial to gaining and retaining the trust of investors and other stakeholders (*#1 what is ESG?* 2022).

Corporate scandals such as Enron and Worldcom have highlighted and reinforced the significance of ethical and efficient governance. Global initiatives like the Sarbanes-Oxley Act in the US and the "Código de Buen Gobierno de las Sociedades Cotizadas" (Code of Good Governance of Listed Companies) in Spain place strict obligations on publicly traded corporations to improve financial reporting or ensure good corporate governance, which demonstrates a worldwide commitment to improving corporate governance, ensuring that companies are profitable, fair and responsible.

2.3.4 Analysis of ESG Factors

ESG ratings originated in the 1980s, with the establishment of Eiris in France in 1983. ESG ratings initially started as a niche interest for a specific group of investors, such as faith based groups, but with the growing significance of sustainable investing, the demand of ESG ratings increased (Berg, Koelbel, & Rigobon, 2022). The ESG ratings have now grown to be an important statistical factor for stakeholders and shareholders, it allows to place a numerical data on an organization's sustainable efforts and performance.

For the analysis of the ESG factors in this research, the ESG Disclosure Score from Bloomberg was used. The ESG Disclosure Score is a percentage that represents the extent in which the company discloses quantitative ESG data based on the global standards that are the most applicable to the industry. However, it's important to acknowledge that there can be a disparity in ESG ratings depending on the agency (Liu, 2022). According to Berg, Koelbel, & Rigobon (2022), platforms can have different ways of measuring the scope and weight of ESG performance, and can be based on subjective interpretations. Therefore, this can provide a limitation to the research as the results may vary depending on the platform utilized to gather the ESG Disclosure Scores.

2.4. ESG Regulations in the Spanish Banking Sector

All over the world, countries have been implementing ESG strategies into their businesses, and Spain has become a leader in the integration of such principles into its economic landscape. The incorporation of ESG (environmental, social, and governance) principles into the Spanish banking industry has seen substantial development over the years, driven both by European and national legislation designed to foster sustainability, transparency, and accountability. It's very important for financial institutions to work on these ESG principles due to their extensive influence and effect on individuals, communities, and the economy. Spain's implementation of these regulations demonstrate the dedication to align the financial sector with global sustainability, including the United Nations Sustainability Goals (SDGs) and the Paris Agreement on Climate Change.

The turning point for Spain occurred in the early 2000s when the United Nations created the Principles for Responsible Investment (PRI, 2005). This event made European companies implement and think about environmental, social, and governance factors when making investment decisions. This event paved the way for a sustainable finance road for the future.

In 2014, the European Commission introduced the Non-Financial Reporting Directive (NFRD), which requires financial institutions that have more than 500 employees to disclose non-financial information on aspects of the environment, social and labor issues, human rights, and measures taken to prevent corruption and bribery (European Parliament, 2021). The NFRD was introduced into national law with the enactment of Law 11/2018, of December 2018.

Building upon the foundation laid by the NFRD, the European Union enhanced its legal structure by implementing the Second Shareholder Rights Directive (SRD II) and the Sustainable Finance Disclosure Regulation (SFDR), also referred to as EU Regulation 2019/2088. The SRD II's aim is to improve corporate governance by promoting the involvement of shareholders in EU-listed firms (EuroNext). The SFDR, which came into effect in 2021, requires asset managers and other participants in the financial market to disclose ESG information (Holland & Nelson, 2021). The main objective is to level the playing fields for financial advisors and market participants by providing information on sustainability in financial products, taking into account sustainability impacts in investment processes, and being transparent about sustainability risks. The SFDR is complemented by the European Green Taxonomy Regulation, which classifies environmentally sustainable economic activity (JP Morgan Asset Management, 2023).

Additionally, The Action Plan for Financing Sustainable Growth, was released by the European Commission in 2018, aiming to align the financial sector with the objectives of the European Union. One of its main goals is to redirect capital towards sustainable investments by creating an EU Taxonomy to categorize sustainable activities, encourage the use of green bonds, and advocate for projects that support environmental sustainability (Gómez Martínez, 2022). Furthermore, in 2019, the European Commission released the European Green Deal as the European Union's proactive initiative to address the impacts of climate change. It was a strategy for the EU to transition into a modern, competitive, and resource-efficient economy with zero net greenhouse gas emissions by 2050. This ambitious program is compelling Spanish banks to integrate climate risks and opportunities into their investment and operational strategies (Comisión Europea, 2019). The Green Deal has resulted in the creation of multiple regulations and guidelines, that included the EU Green Taxonomy (Climate Delegated Act) and six additional delegated acts for financial companies to incorporate sustainability into their operations and client advisory services (Comisión Europea, 2019).

The EU Green Taxonomy, established under Regulation (EU) 2020/852, defines the standards to define whether an economic activity is considered ecologically sustainable. The taxonomy was created to direct capital flows towards sustainable activities within the EU. Its purpose is to assist Europe to reach its goals of becoming climate neutral by 2050, by assisting investors in identifying sustainable technologies and businesses (Comisión Europea, 2022).

Additionally, as a supervisory authority, the Bank of Spain published guidelines and recommendations to encourage the incorporation of ESG factors into financial risk management. In 2020, it issued the “Banco de España supervisory expectations relating to risks posed by climate change and environmental degradation" (Banco De España, 2023), a guideline on environmental and social risk management in lending activities, to ensure that financial institutions properly consider the risks of environmental and social factors in their credit decisions.

Moreover, there are laws printed that financial institutions must follow to disclose ESG information and to improve their decisions on climate risk. Starting with the Law 7/2021 on Climate Change and Energy Transition (2021). This regulation is in accordance with the rules set by the European Union, Spain's obligations under the Paris Agreement on climate change , and the Sustainable Development Goals (SDGs) established by the United Nations. This law reinforces the focus on sustainability and climate change mitigation, as it establishes an obligation for financial firms to incorporate climate risks and opportunities into their strategies and policies. It has set specific targets to achieve by 2030, such as decreasing primary energy usage by 39.50%, ensuring a 42% renewable energy consumption, and achieving a 23% decrease in greenhouse gas emissions (Pacto Mundial Red Española, 2021).

Also, European credit institutions are required by Delegated Regulation 2021/2178 (Pillar 3), to publish information on their exposure to ESG risks (*Commission delegated regulation (EU) 2021/2178 - EUR-Lex* 2021). This data includes qualitative and quantitative information on social rights, pollution, diversity, climate change, etc., and has to be released once a year.

In summary, the ESG regulations governing Spain's banking sector are composed of both European and national laws, with the aim of encouraging accountability, transparency, and the incorporation of sustainable standards into financial operations. The Bank of Spain has been an essential authority to supervise and enforce compliance with these requirements.

2.5. ESG and Profitability in Banking Sector

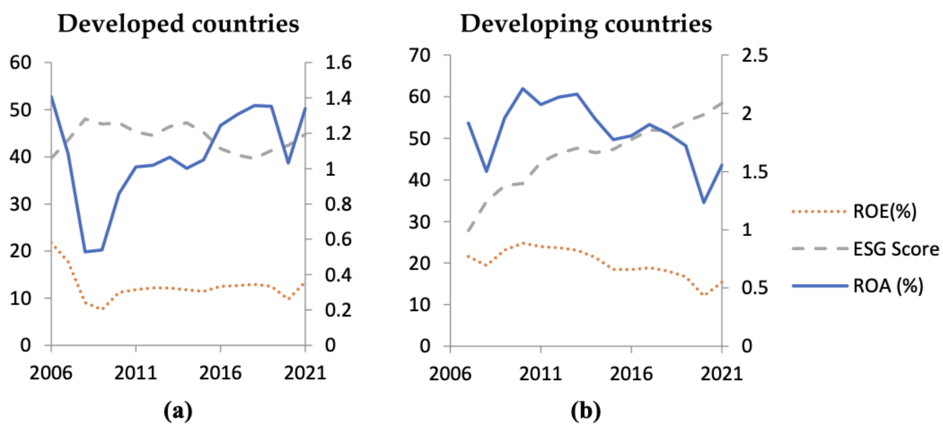
The relationship between sustainability, assessed by the ESG factors, and the financial performance of banking institutions has been a main focal point in economic and financial studies. This interest has increased due to the rising awareness of sustainability practices in this sector, as well as investor requests for responsible business practices. Several studies have analyzed how ESG can affect profitability and growth.

Dragomir et al. (2024) performed a study that examined how ESG factors affected the financial performance of 333 banks in Europe, America, and Asia before and during the Covid-19 pandemic. In 2020, banks' environmental performance negatively affected their return on equity, and there was no substantial impact from the other ESG pillars. On the other hand, social responsibility initiatives had a positive effect on bank profitability in 2021. This study emphasizes the intricate connections between ESG practices and financial performance, indicating that the impact can differ based on the specific ESG elements and the time frame analyzed.

Additionally, Xu's (2024) research focuses on analyzing the MSCI ESG ratings of an Industrial Bank, demonstrating that ESG practices have a favorable influence on firm valuation. In this case, Banco Industrials' consistent high ESG rating throughout the years led to an improvement on their profitability and growth capacity, outperforming the banking industry's average. This report highlights the importance of ESG ratios to evaluate financial performance and sustainability in the banking sector, demonstrating how strong ESG performance may enhance long-term business value.

Figure 2:

Evolution of global banks' profitability and ESG activities (2006-2021)



Note(s): ROA (right axis), ESG Score and ROE (left axis)

Note(s): ROA (right axis), ESG Score and ROE (left axis)

Source: (Yuen et al., 2022)

The research obtained by Peterson K.Ozili (2023) also demonstrates that attaining health and well-being goals increases banks' non-financial income. Ensuring access to clean water and sanitation boosts banks' return on assets. And enhancing education quality and advocating for accessible and sustainable energy resources result in a rise in a bank's return on equity.

Nevertheless, Yuen et al. (2022) investigated the correlation between Environmental, Social, and Governance (ESG) initiatives and the financial performance of banks worldwide. Forty six banks were analyzed from different countries during 2008 to 2019, were the impact of ESG was analyzed on variables such as ROA, ROE, and market indicators such as Tobin's Q and stock returns. The study discovered a non-linear correlation between ESG activities and bank profitability, indicating that ESG investments may neither increase or decrease profitability in a consistent manner. The study also highlighted that the various ESG pillar had different effects on financial success, concluding that investing in governance can improve financial outcomes only to a ceratin extent, and that the environmental aspect will increase the financial outcomes over time. Notwithstanding, the results varied depending on the geographic region.

The research indicates that the relationship between ESG and financial performance in banks is complex, and it can be affected by various external and internal factors. However, there is a growing tendency among investors to value and acknowledge ESG practices and their potential impact on profitability, growth, and long-term sustainability. This underlines the importance of focusing on ESG practices in order to enhance corporate responsibility and to ensure long-term financial success.

To conclude, the literature examined confirms that ESG performance can have a varied effect on the profitability and growth of a bank. It is important to understand that the effect ESG practices have on financial performance can depend on many factors such as region, ESG practices utilized, and market conditions. There is still more research to be done to comprehend further the complex dynamics of ESG and how it affects the global banking sector.

CHAPTER 3: EMPIRICAL ANALYSIS OF GROWTH, PROFITABILITY, AND ESG IN THE SPANISH BANKING SECTOR IN YEARS 2015- 2022.

In this section, we will analyze the Spanish banks listed on the IBEX 35, consisting of Bankinter, BBVA, Caixabank, Sabadell, Santander, and Unicaja. We will analyze profitability, growth and ESG factors during the period of 2015 to 2022, which include the Revenues, Market Cap, ROE, ROA and ESG Disclosure Score. The purpose of this section is to identify and analyze the performance of these banks, identifying if its possible to incorporate ESG factors while maintaining their profitability and growth.

3.1 Methodology and data

This study is based on analyzing the Spanish banks listed on the “Bolsa de Madrid's” benchmark stock market index, IBEX 35. The banks belonging to the IBEX 35 are Bankinter, BBVA, Caixabank, Sabadell, Santander, and Unicaja. By focusing on these banks, we will be able to gain information from the most significant and liquid companies. Notwithstanding, we will be able to get an extensive perspective of the Spanish banking sector, gaining insights into the ways in which growth, profitability, and ESG factors interact in the financial sector.

For starters, to ensure the data obtained is reliable and up to date, the main data source utilized was Bloomberg. As Bloomberg has a broad financial coverage, it guarantees that the data collected is accurate and consistent among all the banks. Important variables that represent growth, profitability, and ESG factors were obtained from the platform. Both revenue and market capitalization were taken into account for the variable growth. The return on equity (ROE) and return on assets (ROA) were obtained to measure the profitability element. And lastly, within the field of ESG, the primary data obtained was the ESG Disclosure Score.

Moreover, to analyze the data, data was collected from the years 2015, 2018, and 2022; these years provide the earliest and latest information on ESG scores. This range of years enables an efficient analysis to be provided, as patterns and developments in the banking sector can be analyzed over a short and long period of time. The data from these years will provide a distinct insight into the evolving dynamics of growth, profitability, and ESG practices over time.

The methodology of this project consists of calculating the average of all banks for each variable and for each of the chosen years. This average will act as a benchmark to identify those banks whose performance on a specific variable exceeds the average, indicating better performance in that area. This method enables a straightforward comparison of banks, emphasizing those that show outstanding performance. Additionally, the Compound Annual Growth Rate (CAGR) was computed for each variable and bank for the years 2015 to 2022. While the CAGR does not directly indicate the best-performing bank, it offers insight into the progress and evolution of each bank over time.

Based on these analyses, banks will be categorized into distinct categories according to their performance in profitability, growth, and ESG factors. Inspired by the McKinsey article, banks that excel in the three variables will be characterized as “Triple Play” (Doherty et al., 2023). Additional categories will be created for banks that excel in one characteristic or two to highlight each bank’s strength and area of growth.

This methodology identifies the top performers in the Spanish banking sector based on growth, profitability, and ESG standards, as well as acknowledges those who have demonstrated a notable improvement in each of the areas. This detailed classification simplifies the understanding of the competitive dynamics in the industry and highlights the strategies that lead to long-term success.

3.2 Calculating Changes in Growth, Profitability, and ESG

In this section, we utilize a visual method to examine the changes in growth, profitability and ESG factors in the Spanish banking sector throughout 2015 to 2022. We provide a clear picture of each bank's performance trajectory by using bar graphs that show the changes in these factors in the years 2015, 2018, and 2022. We evaluate the best performing banks by indicating which of them have the highest values, as those with the best improvements by analyzing their growth throughout these years. These results will provide an insight into those banks that utilize a "Triple Play " strategy (one that incorporates growth, profitability and ESG), and those that have high performance in one or two of these aspects.

As mentioned, different variables were analyzed for the growth, profitability, and ESG factors. To start with, the graphs displayed are bar diagrams that represent the evolution of the variable being analyzed over three years (2015, 2018, and 2022) for each bank. The names of the banks are displayed on the x-axis, and the numerical variable being studied is displayed on the y-axis. Each bank is represented by three different colored bars: one for each year analyzed. This enables us to see the historical trends of the variable for every financial institution. Furthermore, above the three bars, a percentage is shown that indicates the Compound Annual Growth Rate (CAGR) of the variable from the year 2015 to 2022 for that particular bank. The CAGR was calculated through this equation:

$$CAGR = \left(\frac{Ending\ Value}{Beginning\ Value}\right)^{(1/t)} - 1$$

* "t" represents the number of years

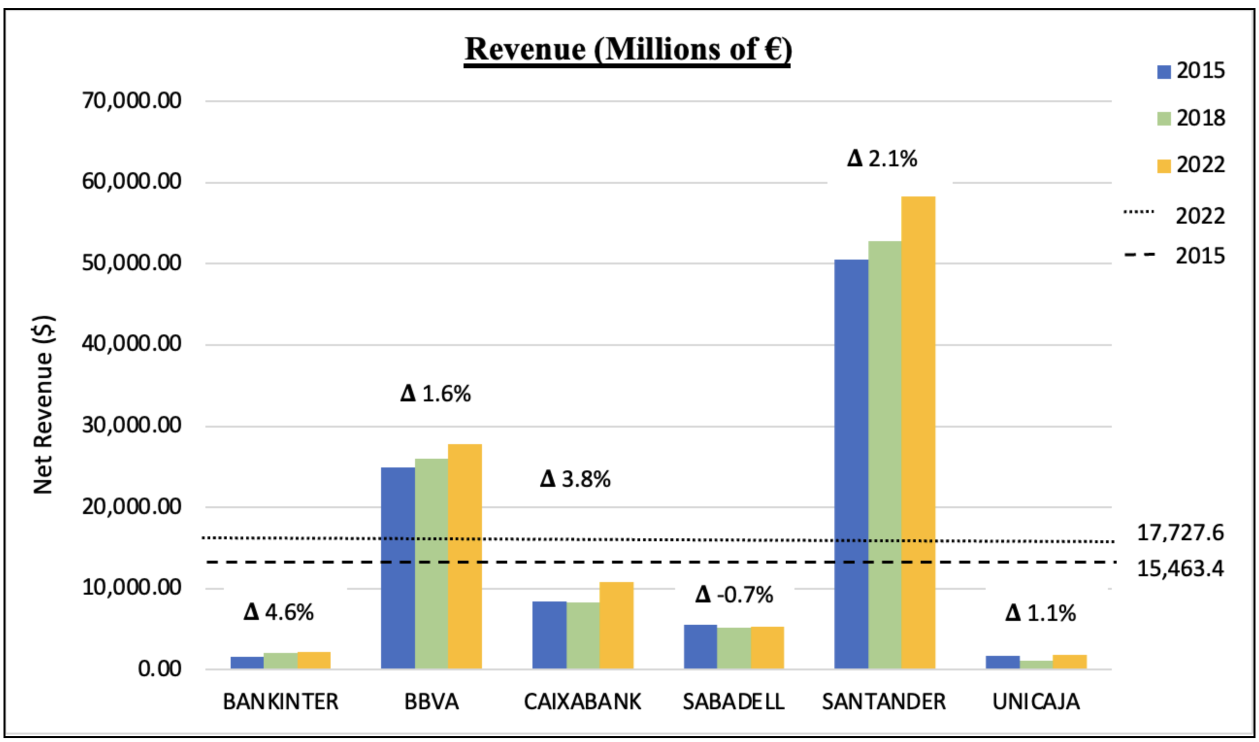
Additionally, the graph includes two horizontal lines: one represents the average of the values of the variable in 2015, and the other represents the average of the values in 2022 for all banks.

3.2.1. Growth Analysis

Revenue and Market Cap are essential factors for evaluating the growth and financial well-being of firms. Revenue is the total amount of money generated by the company from its sale of goods and services before deducting any costs. This financial metric indicates the ability of a company to attract and retain customers, as well as the effectiveness of its business strategy and the demand for its products and services. The market capitalization is a financial metric that represents the overall value that the market attributes to the company at a specific point in time. It is calculated by multiplying the company's current share price by its total shares outstanding. A high market cap in the banking sector reflects a positive investor perception on the bank's stability and potential for future expansion. Overall, it is a valuable indicator of market confidence.

Figure 3:

Comparative revenue of Spanish Banks (2015-2022)

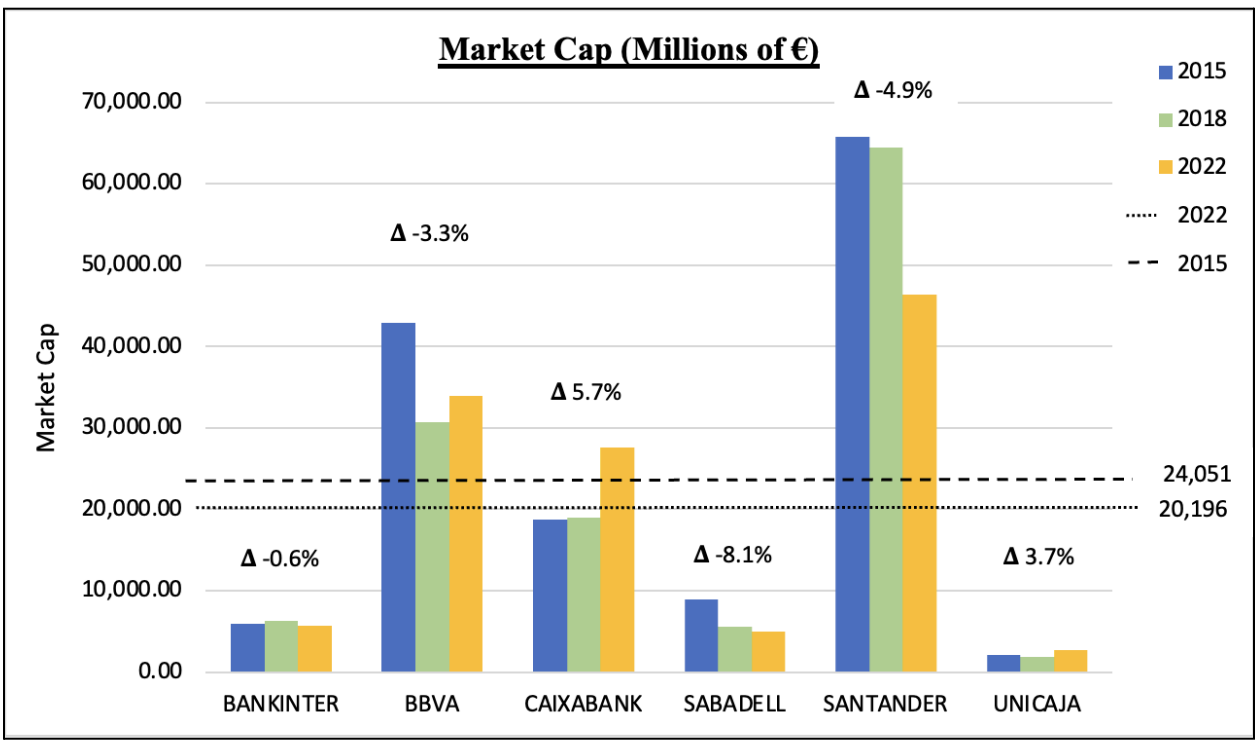


Source: Own elaboration with Bloomberg data

With the exception of Bank Sabadell, most banks experienced a growth in revenue from the year 2015 to 2022. Santander leads by a substantial margin, indicating a strong revenue-generating capacity. This leadership can be attributed to the fact that Santander is Spain's largest bank and its emphasis on digitalization and regional diversification, enabling it take advantage of new opportunities and counteract the negative impacts of a challenging economic environment. Sabadell experienced a 0.7% compounded annual drop in revenue, indicating the bank encountered particular difficulties. BBVA and Santander Bank demonstrate outstanding income production, surpassing the average income levels between 2015 and 2022, illustrating their ability to create wealth during a challenging economic moment. Bankinter, although it has a low revenue, it experiences a 4.6% compounded annual growth, giving high expectations for future revenue.

Figure 4:

Comparative market cap of Spanish Banks (2015-2022)



Source: Own elaboration with Bloomberg data

An analysis of a bank's success in the financial sector can be obtained by examining the Market Cap and its growth. Firstly, from the bar diagram, we can see that most banks saw a decrease in their Compound Annual Growth Rate (CAGR) from 2015 to 2022. This decrease can be attributed to the economic slowdown and increase in interest rates, which caused the financing in the form of capital and IPOs to fall in 2022 (BME, 2022). Nevertheless, Caixabank and Unicaja stand out by successfully maintaining and increasing their CAGR over this timeframe.

When assessing the comparative performance of banks in terms of surpassing the average "Market Cap", it is observed that BBVA, and Santander excel in both 2015 and 2022, Santander having the largest Market Cap among all. This indicates a consistency in how the market perceives the long-term growth prospects of these companies; it displays that the market trusts in their capacity to produce long-term value. Additionally, the other bank that surpassed the average Market Cap in 2022 was Caixabank. Although it did not overperform in 2015, Caixabank will be considered as an high performance bank in growth due to its notable improvement in compound annual growth rate (CAGR) and its ability to surpass the average in 2022. This indicates a favorable shift in the market's image of Caixabank, potentially influenced by strategic measures taken by the organization to enhance its expansion.

In conclusion, this analysis demonstrates that the Spanish banks BBVA, Caixabank, and Santander, have successfully expanded and boosted their market worth, demonstrating investor trust in their approach and leadership despite economic challenges.

3.2.3. Profitability Analysis

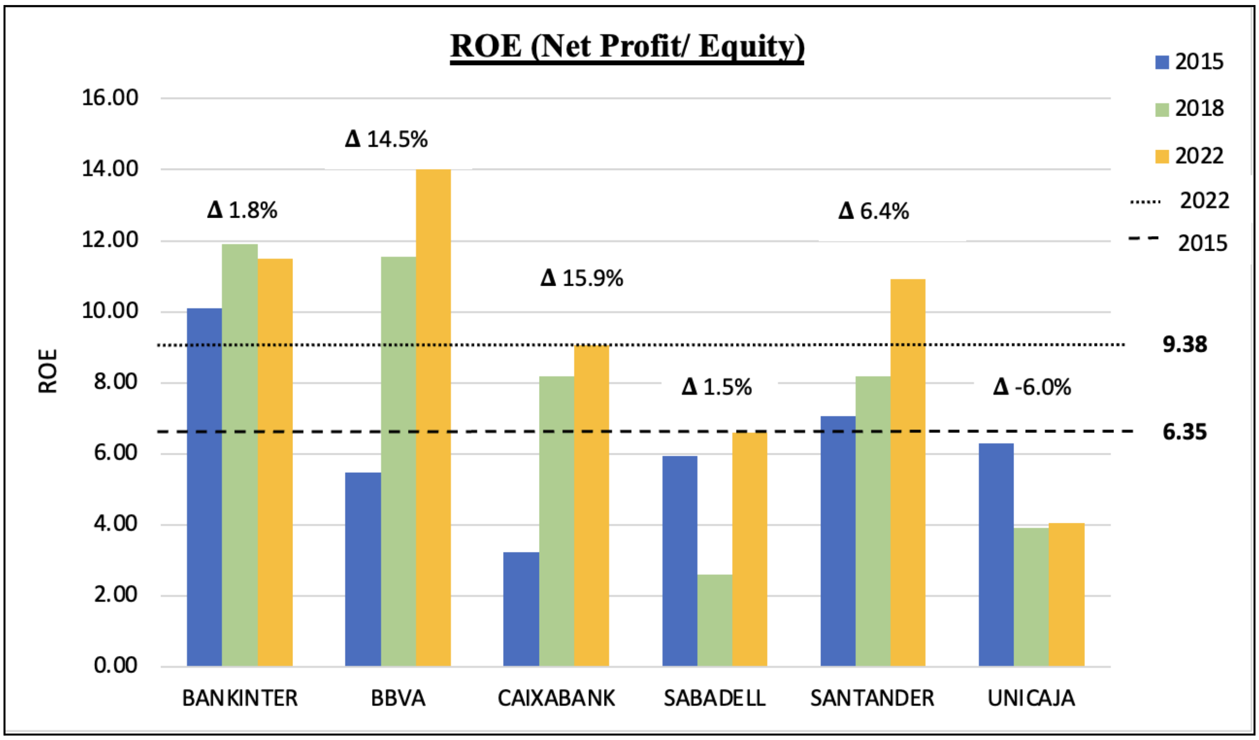
To analyze the profitability of the banks, the financial metrics, ROE and ROA, were taken into account. These metrics display how a company utilizes its resources to generate profit, which are essential elements for investors and managers when assessing the financial health and operational effectiveness of banks.

Return on Equity (ROE) is calculated by dividing the company's annual profit by its shareholder's equity. This metric displays how much profit a company generates for each euro invested by the shareholders, demonstrating the organization's ability to create value for its shareholders. Return on Assets (ROA) measures how efficiently a company uses all its resources to generate profit, independent of its financial structure. The financial metric is calculated by dividing the yearly net profit by the total assets. Thus, ROA gives insight into how well management is utilizing its assets to create a profit.

By jointly analyzing the ROE and ROA, we can identify significant patterns of financial performance and operational efficiency. This thorough assessment helps us understand how these businesses have successfully adapted and developed in response to the challenges posed by the regulatory and economic environment.

Figure 5:

Comparative ROE of Spanish Banks (2015-2022)



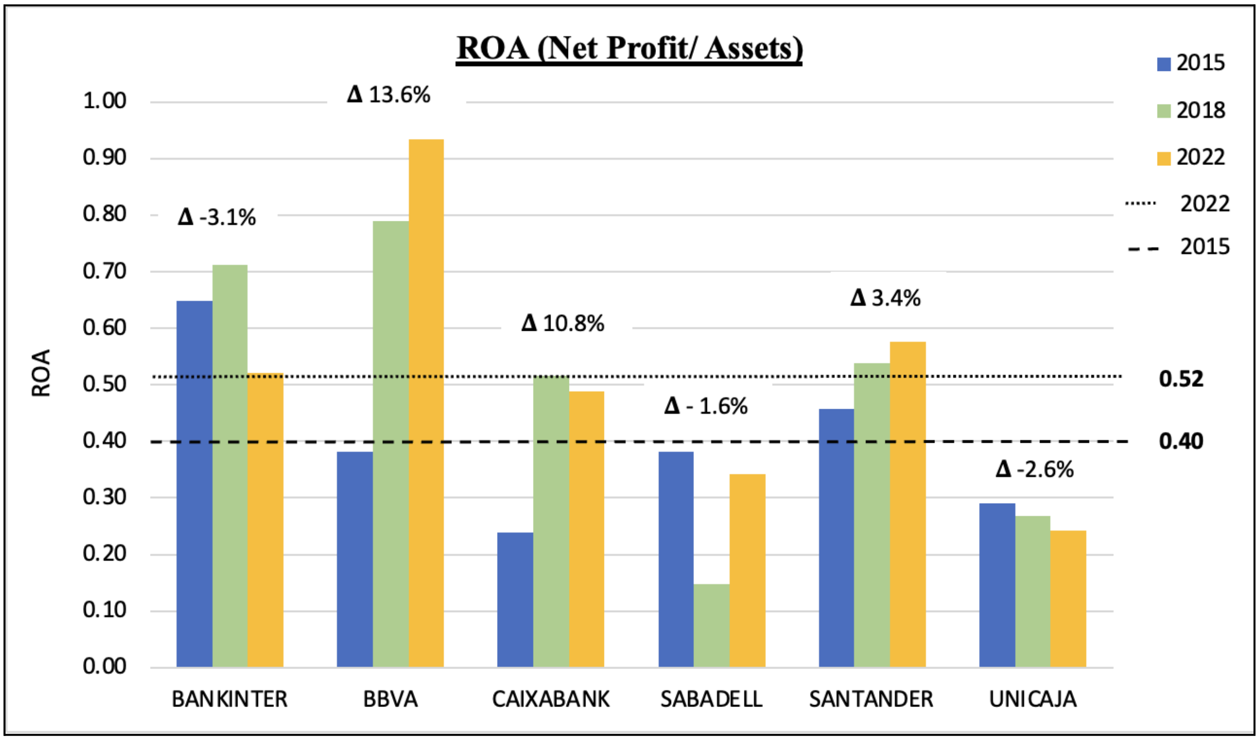
Source: Own elaboration with Bloomberg data

The ROE experienced significant increases in most banks, with BBVA and Banco Sabadell achieving the highest annualized growth rates of 14.5% and 15.9%, respectively. The only bank that did not experience any growth was Unicaja, which had a CAGR decrease of 6.0%. BBVA also surpassed the average ROE in 2022 and showed the most notable improvement since 2015 While BBVA did not overpass the 2015 average, it showed an immense capability of growth, which indicates an improvement in the banks' efficiency in generating profits. The low yield environment during 2015 could explain BBVA's initially low ROE, as banks struggled to generate profits during that time. However, its increase in ROE through the years has made

BBVA establish itself as one of the top-performing banks, alongside Bankinter and Santander. The three banks surpassed the average ROE in 2022, demonstrating they have outperformed the market in terms of return on capital, highlighting their effectiveness both strategically and operationally in a challenging environment.

Figure 6:

Comparative ROA of Spanish Banks (2015-2022)



Source: Own elaboration with Bloomberg data

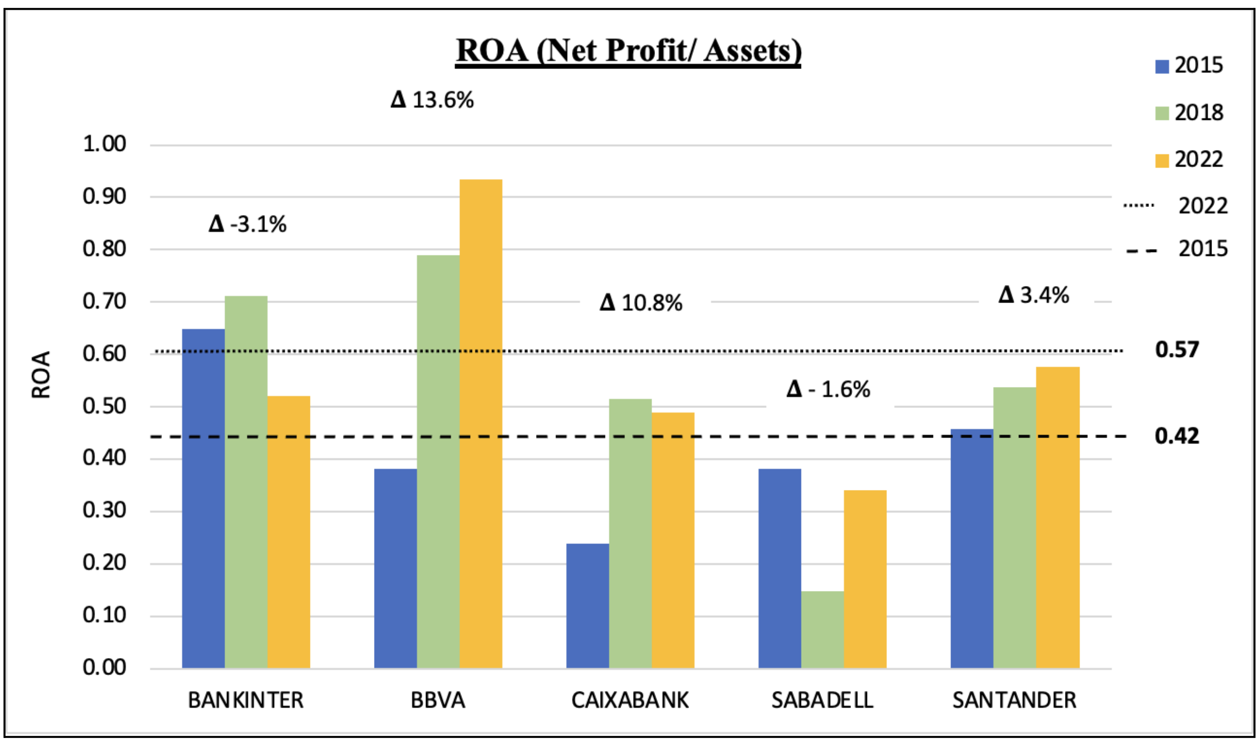
ROA, which measures how efficiently a bank can generate profits from its total assets, has also seen growth in most banks, except for Bankinter, Sabadell, and Unicaja. BBVA and Caixabank experienced the highest CAGR, with an increase of 13.6% and 10.8%, from year 2015 to 2022, indicating effective use of assets in a difficult financial environment; however, even with that growth, Caixabank was not able to surpass the average ROA's for 2015 or 2022. BBVA demonstrated exceptional performance in 2022 by achieving the greatest Return on Assets demonstrating its effective management and strong ability to adapt to market conditions. Overall, the best-performing banks in ROA were Bankinter, BBVA, and Santander, as they exceeded the average ROA in 2022.

It's important to notice that although BBVA has had the highest performance and growth in both ROE and ROA, Santander and Bankinter (even with its CAGR decrease) have been the two banks that surpassed the average ROE and ROA in both 2015 and 2022. This reflects that BBVA may have been impacted harder by the low interest environment during the years of 2015 onwards, which is why its results were lower during that year. On the other hand, Santander and Bankinter have been able to perform above all the other banks even with the stressful and difficult economic situation.

Considering that Unicaja's performance in both ROE and ROA are lower in comparison to its competitors, we decided to analyze these two factors excluding Unicaja's values to identify whether the elimination of the bank's values would change our analysis.

Figure 7:

Comparative ROA of Spanish Banks without Unicaja (2015-2022)



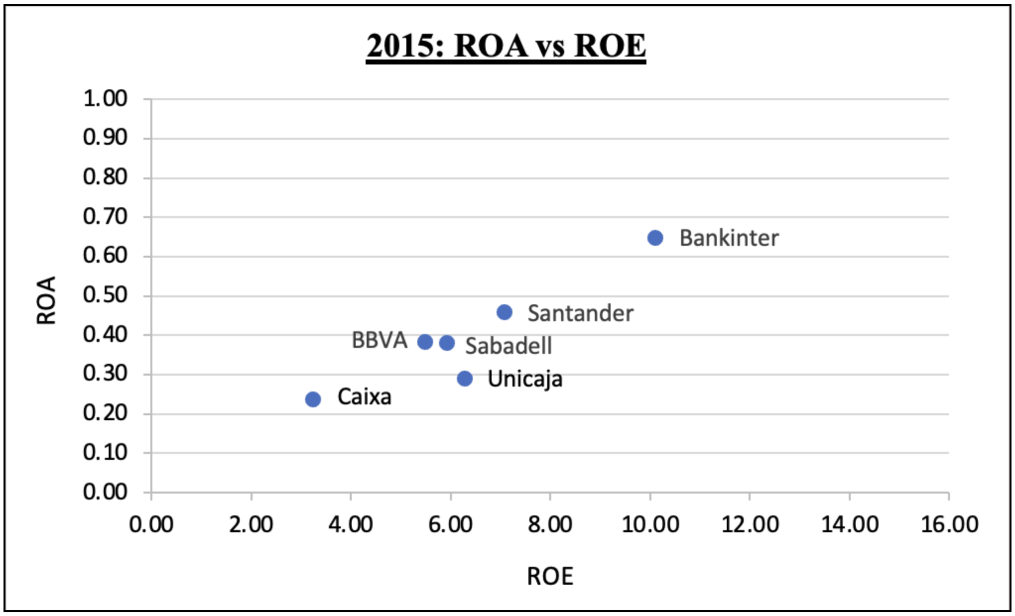
Source: Own elaboration with Bloomberg data

As mentioned, another bar graph was developed excluding the data from Unicaja, as its low figures affected the analysis by bringing the average of 2015 and 2022 lower. After removing Unicaja's data, the only variable it truly impacted which changed the analysis was the ROA. As portrayed in the graph, BBVA is still the best performing bank in terms of this variable. On the other hand, with the removed data from Unicaja, Bankinter no longer surpasses the average of 2022. Although it does not surpass the average in 2022, Bankinter is still considered an overperforming bank in this variable as we believe it is more valuable that the profitability invested by shareholders (ROE) increases rather than its management of assets. It is also seen that the ROA of Santander in 2022 only surpasses the average by a small figure, displaying that BBVA's performance is truly a remarkable competitive advantage against its competitors.

In order to further assess the relationship between ROA and ROE for the years 2015 and 2022, a scatter plot has been created with both financial indicators to determine which banks have the greatest values for both. Each data point represents a bank, and its position reflects its ROE and ROA values for the corresponding year. By adding the two graphs, we will be able to determine how these indicators have evolved over time and identify the banks that have either maintained or improved their financial performance.

Figure 8:

Comparative ROA and ROE of Spanish Banks (2015)

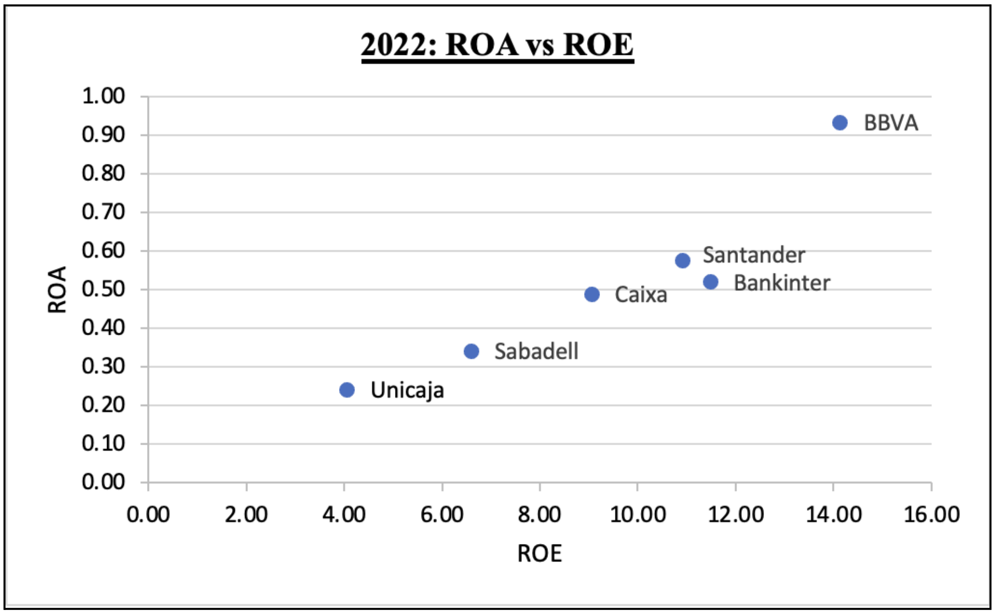


Source: Own elaboration with Bloomberg data

Bankinter distinguished itself for having the highest ROA and ROE in the year 2015, indicating its strong financial performance. This indicates that Bankinter was efficient at managing its assets to generate profits and knew how to maximize shareholder returns by using its capital efficiently. On the other hand, Caixabank had the lowest scores across the board for both metrics, signaling potential problems that could be related to internal operating factors or Spain's economic climate. The other banks are in intermediate positions on the graph, indicating relatively homogenous financial performance in terms of ROA and ROE.

Figure 9:

Comparative ROA and ROE of Spanish Banks (2022)



Source: Own elaboration with Bloomberg data

Moving on, in 2022, BBVA emerged as the leading bank with the highest ROE and ROA, demonstrating the strongest financial performance. Santander demonstrated an improvement in its performance as well. Bankinter maintained a strong financial position; however it experienced a decrease in ROA. Additionally, Caixabank saw a notable improvement in its performance, overcoming early difficulties and exhibiting a noteworthy comeback in terms of efficiency and profitability. This shift may be the result of several strategic and operational changes made to strengthen the company's financial standing. Lastly, Unicaja's poor performance was due to its sharp decrease in ROE, demonstrating difficulties in sustaining its profitability and capital efficiency.

The scatter plot analysis has created an image of the trends of profitability and efficiency in the Spanish banking sector during the years 2015 and 2022. Banks' performance in these key financial indicators reflects their ability to adjust to shifting regulatory and economic environments as well as their efficiency in managing the company. While some banks, like BBVA and Santander, showed remarkable resilience in sustaining and enhancing their financial performance, other banks, like Caixa or Unicaja, encountered difficulties. These trends highlight the importance of resilience and innovation to adapt to the regulatory and competitive landscape.

Overall, the analysis of ROE and ROA reveals that banks like Bankinter, BBVA, and Santander have not only exceeded the averages of these indicators but have also demonstrated consistent growth and improved efficiency, establishing themselves as top performers in the Spanish banking industry.

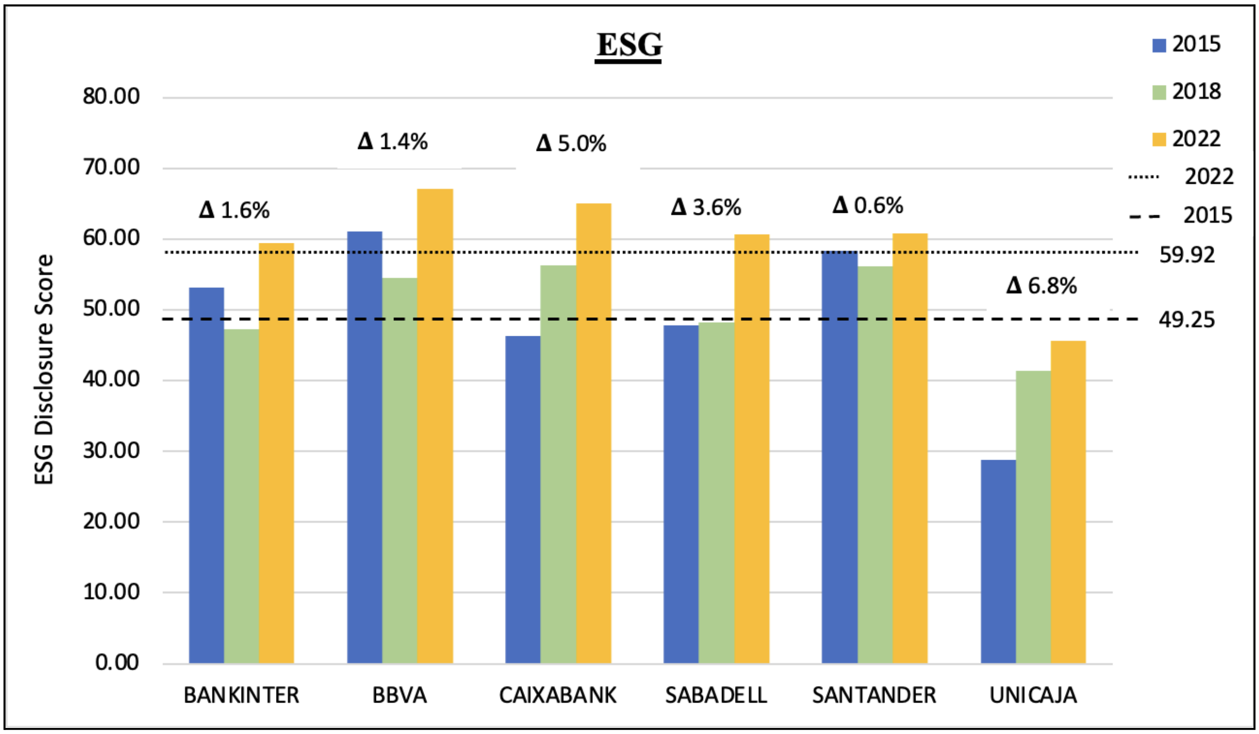
3.2.4 ESG Analysis

The ESG Disclosure Score is a statistic that analyzes the transparency and depth in which corporations disclose their practices and performance in relation to environmental, social, and governmental practices. This score is crucial for investors and other stakeholders to determine a company's dedication to sustainable and responsible operations. A high ESG Disclosure Score signifies that the organization implements strong ESG policies and is dedicated to transparently communicating its initiatives and outcomes in these areas. They are also perceived as having lower risk and more equipped to tackle forthcoming issues associated with climate change, resource management, social fairness, and corporate administration.

Bloomberg's ESG Disclosure Score assesses a company's strategy in managing factors that could affect its financial performance, including revenue, operating costs and asset values. The evaluation relies on Bloomberg's exclusive investigation, which identifies these key risks by examining the probability, magnitude, and timing of their potential impacts. The scores go from 0 to 100, with higher values denoting exemplary management of ESG matters. Bloomberg relies on quantitative data sourced from publicly available company disclosures, eliminating the use of estimations or subjective analyst views. The scoring process is characterized by transparency, as the methodology and underlying data are readily available. And Bloomberg also categorizes companies into peer groups based on their business models and ESG challenges, ensuring that comparisons are both fair and relevant. The scoring model incorporates multiple degrees of detail, ranging from an overall ESG score to detailed field scores. Each level contributes to the overall evaluation according to its significance (Bloomberg, 2023). More information on Bloomberg's ESG Scores process is included in Annex 1 & 2.

Figure 10:

Comparative ESG of Spanish Banks (2015-2022)



Source: Own elaboration with Bloomberg data

The bar graph to analyze the ESG performance of Spanish banks from 2015 to 2022 has demonstrated significant developments in the adoption of sustainable and ethical practices within the Spanish banking industry. All banks' performance on ESG improved during this time period, demonstrating the shift in the sector's priorities and the response for greater transparency and commitment to sustainability from investors, regulators, and customers.

The noteworthy improvement in Caixabank and Unicaja's ESG performance (5.0% and 6.8% compounded annual growth) showcases the dedication of these organizations to implement ethical and sustainable business practices. This signifies a notable shift in corporate culture and business strategy to match the evolving expectations of society and the market. Additionally, BBVA being the bank with the highest ESG performance in 2022, exemplifies industry leadership in sustainability. This accomplishment shows that BBVA has effectively incorporated ESG standards into its operations, investment strategy, and business model.

Moreover, in 2015, only Bankinter, BBVA, and Santander surpassed the ESG performance average, suggesting these institutions were already progressing toward sustainable operations during this time. Their notable standing during this period is a result of their early adaptability to ESG practices, which may have provided a competitive edge. By 2022, the banks' positions drastically changed, with every bank - aside from Unicaja - exceeding the ESG performance average. This shift reflects the changed and consistent work to reach to a more sustainable environment. The widespread improvement in ESG performance indicates the active response from banks to stricter regulations, increasing stakeholder pressure, and the recognition of the importance of sustainability for long-term growth.

Additionally, in order to analyze whether the ESG scores of the banks are actually satisfactory, Deloitte's analysis on ESG Scores was taken as reference in order to a assign the banking institutions with ESG grades varying from poor (D) to excellent (A).

Figure 11:

Environmental, Social and Governance Scores (Deloitte)

Score	Grade	Description
0 - 8	D-	'D' score indicates **poor** relative ESG performance and insufficient degree of transparency in reporting material ESG data publicly.
8 - 17	D	
17 - 25	D+	
25 - 33	C-	'C' score indicates **satisfactory** relative ESG performance and moderate degree of transparency in reporting material ESG data publicly.
33 - 42	C	
42 - 50	C+	
50 - 58	B-	'B' score indicates **good** relative ESG performance and above average degree of transparency in reporting material ESG data publicly.
58 - 66	B	
66 - 75	B+	
75 - 83	A-	'A' score indicates **excellent** relative ESG performance and high degree of transparency in reporting material ESG data publicly.
83 - 92	A	
92 - 100	A+	

Source: Deloitte, 2022

With this evaluation metric taken into account, we prescribed the scores to the six listed Spanish banks, to identify whether they achieved a good ESG rating.

Figure 12:

ESG Bank Scores (2015 & 2022)

ESG GRADE	2015	2022
BANKINTER	B-	B
BBVA	B	B+
CAIXABANK	C+	B
SABADELL	C+	B
SANTANDER	B	B
UNICAJA	C-	C+

Source: Own elaboration with Bloomberg data and Deloitte scoring metric

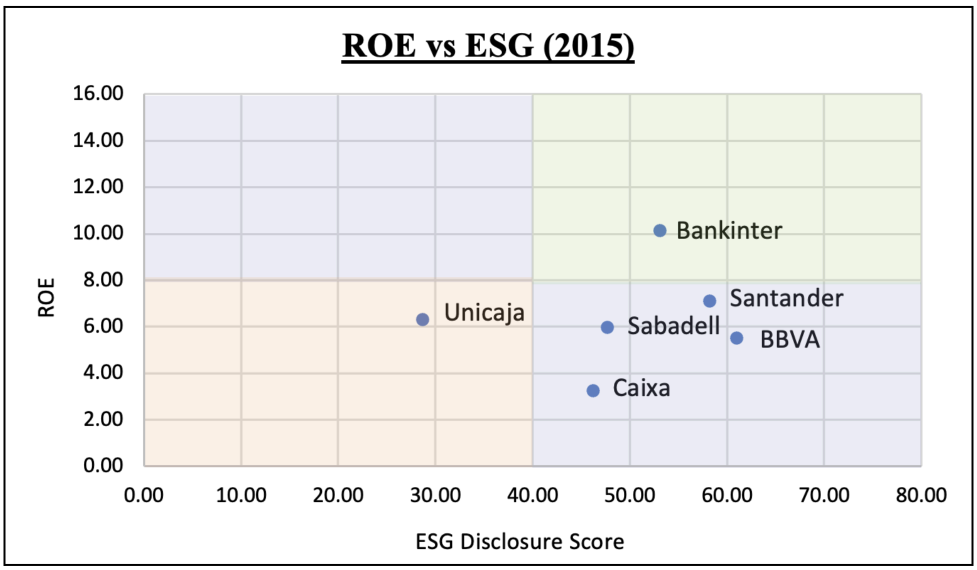
According to the ESG evaluation metric provided by Deloitte, we can see an increase in the scores of all the banks, even if it's by a few quartile of points (increasing only from a B to a B+). Although there is no bank with a excellent score (an A), most of the banks exemplify a good performance (B to B+). This demonstrates that the banks have an above-average degree of transparency in reporting material ESG data publicly. With these scores set in place, we can conclude that while all the banks have experienced growth in ESG performance, there is still room to grow in order to achieve an excellent score. However, the banks with a B score or more have demonstrated adaptability and sustainability initiatives; therefore, they are recognized as overperforming banks in the ESG variable, more specifically, all the banks except Unicaja are perceived as good ESG performers.

3.2.5 ROE vs ESG Analysis

The comparative analysis between Return on Equity (ROE) and the ESG Disclosure Score offers valuable insights into the association between environmental, social and governance sustainability and financial performance in the banking industry. The next analysis considers a scatter plot in 2015 and 2022, separated into four distinct sections (displayed by the different colors), showing specific combinations of ROE and ESG Disclosure Score levels. The green section portrays a high ROE and ESG Disclosure Score, the orange one portrays a low ROE and ESG Disclosure Score, while the blue sections portray either a high ROE and low ESG or a low ROE and high ESG. A data table is also contributed to display the growth in ROE and ESG from the years 2015 to 2022, utilizing the Compound Annual Growth Rate formula. These scatter plots and data tables provide a clear depiction of the relationship between these variables and their changes over time.

Figure 13:

Comparative Analysis ROE vs ESG (2015)

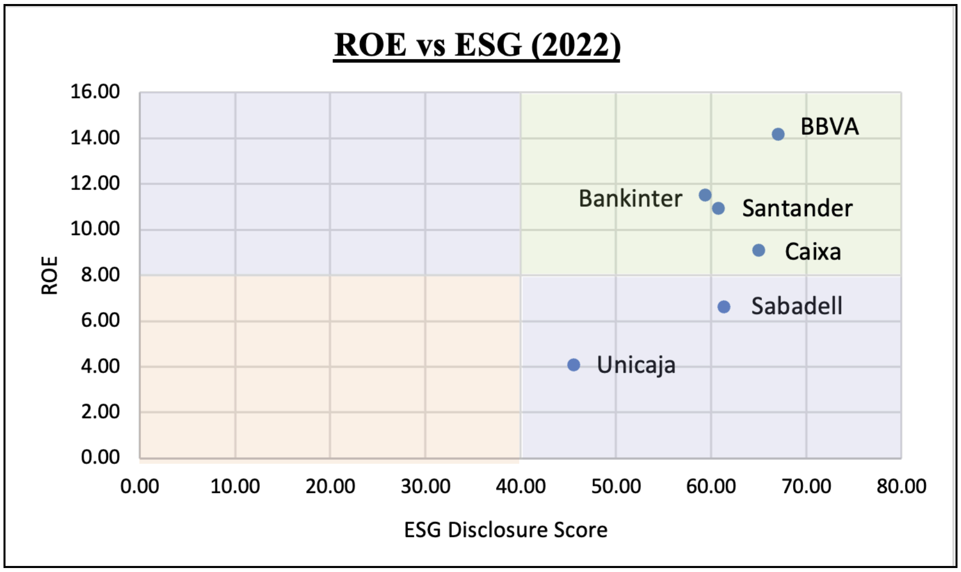


Source: Own elaboration with Bloomberg

In the 2015 scatter plot, Bankinter is the only bank situated in the green section, characterized by high levels of both Return on Equity (ROE) and Environmental, Social, and Governance (ESG) Disclosure Score. Conversely, Unicaja is categorized in the negative section, indicating that it has a low Return on Equity (ROE) as well as a low Environmental, Social, and Governance (ESG) Disclosure Score in comparison to the other banks. The remaining banks are located in the blue area, exhibiting a high ESG Disclosure Score but a comparatively lower ROE in comparison to Bankinter.

Figure 14:

Comparative Analysis ROE vs ESG (2022)



Source: Own elaboration with Bloomberg data

When examining the graph for 2022, there is a notable shift in the distribution of banks throughout the different sections of the graph. Bankinter, BBVA, Caixa, and Santander progress towards the green zone, demonstrating a rise in both the Return on Equity (ROE) and the Environmental, Social, and Governance (ESG) Disclosure Score. These findings indicate there may be a direct correlation between the growth in sustainability and the enhancement of financial profitability for these banks, as a high ESG Disclosure Score has eventually led these banks to acquire a high ROE in the long-term. However, Sabadell is still classified in the blue column, indicating that even with a high ESG Disclosure Score, its Return on Equity (ROE) has not experienced a considerable boost. Additionally, Unicaja has experienced a growth in ESG, but has not been able to increase its ROE.

Figure 15:

Analysis of Growth (CAGR) of ROE and ESG from 2015 to 2022

GROWTH Δ	ROE	ESG
BANKINTER	1.8%	1.6%
BBVA	14.5%	1.4%
CAIXABANK	15.9%	5.0%
SABADELL	1.5%	3.6%
SANTANDER	6.4%	0.6%
UNICAJA	-6.0%	6.8%

Source: Own elaboration with Bloomberg data

The table displaying the compound annual growth rate (CAGR) of environmental, social, and governance (ESG) factors and return on equity (ROE) from 2015 to 2022 offers more understanding of the relationship between both variables. As we can see from the table elaborated above, most banks experienced outstanding growth in ROE from year 2015 to 2022, and the banks that successfully transitioned from the blue to the green category due to this growth are the ones who already possessed a high ESG Disclosure Score in 2015. This can imply that prioritizing sustainability from the beginning can result in a substantial long-term financial gain.

Nevertheless, it is noteworthy that Sabadell is the only bank that is not conforming to this pattern, as it continues to be included in the blue sector despite containing a substantial ESG Disclosure Score. This indicates the necessity for additional investigation and research to comprehend the factors contributing to this inconsistency.

To summarize, the analytical findings conclude what may be a direct correlation between the growth of sustainability and the long-term financial success in the banking industry. This implies that allocating funds to Environmental, Social, and Governance (ESG) initiatives has the potential to yield higher profits for banks in the future. However, it is crucial to consider the particular factors that can impact this correlation, as Sabadell's example does not prove this conclusion correct.

3.3 Triple Play Analysis

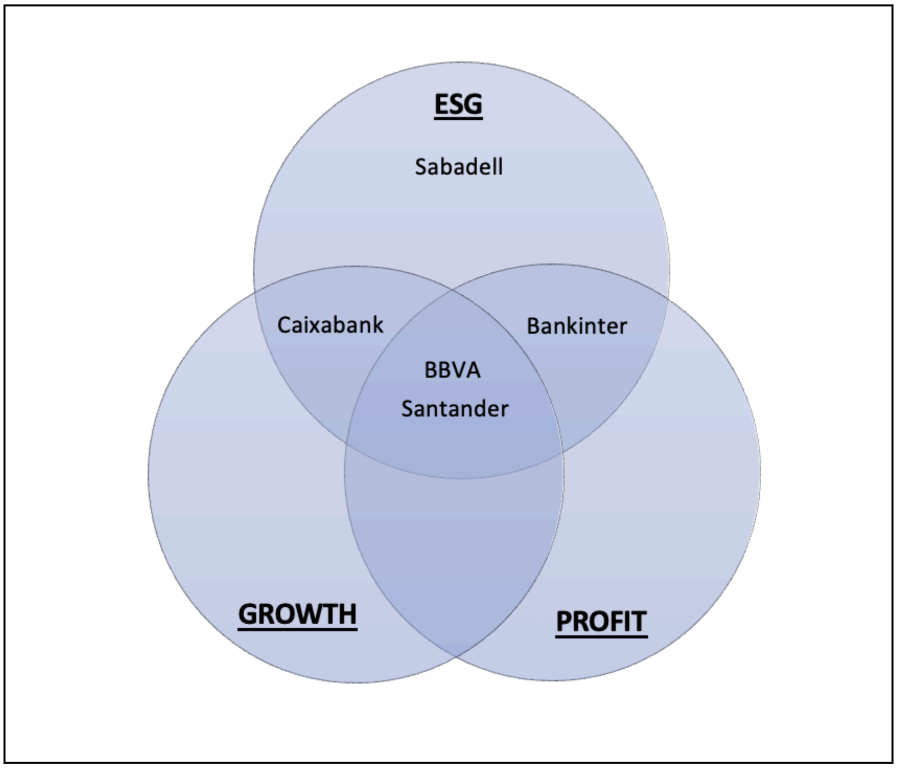
The term “Triple Play” refers to a comprehensive strategy inspired by a McKinsey research paper that simultaneously addresses growth, profitability, and sustainability. This strategy excels in producing revenue and profitability growth while also promoting environmental, social, and governmental concerns. McKinsey states that those organizations that achieve the “Triple Play” reach their financial goals and show a strong dedication to sustainable and responsible business practices. This approach is recognized and rewarded by the market, as companies that integrate ESG principles into their growth and profitability plans tend to outperform their competitors.

According to McKinsey, companies utilizing this approach adhere to five essential principles: integrating growth, profitability, and ESG in their core strategy; innovating ESG offerings to enhance value creation; strategically utilizing mergers and acquisitions to seize ESG growth opportunities; transparently and rigorously communicating about their ESG initiatives and progress; and integrating these strategic priorities into the organizational DNA (Doherty et al., 2023).

From the previous analysis of the Spanish listed banks, we will identify those banks that meet the “triple play” strategy:

Figure 16:

Outperformance in ESG, Growth, and Profit Venn Diagram (2015-2022)



Source: Own elaboration

In order to analyze the "Triple Play" banks, we took into consideration not only whether the banks were able to surpass the variable's average, but their growth as well. The analysis of the listed Spanish Banks in the IBEX 35 in the variables of growth, profitability, and ESG demonstrates that BBVA and Santander stand out as the "Triple Play," exceeding the average in all the variables studied for the years 2015-2022 and exhibiting a constant growth in all the variables. This accomplishment is significant due to the changing economic conditions, constantly evolving regulations, and increasing demand for sustainable and ethical behaviors from customers and investors.

Additionally, Bankinter is a prominent example of a bank that has successfully managed to distinguish itself in ESG performance and financial profitability. The institution acquires a high ESG Disclosure Score, with a rating of B, and demonstrates its commitment to this variable due to the perceived growth from 2015 to 2022. This demonstrates the institutions' commitment to corporate responsibility and risk management in the environmental, social, and governance factors. In addition, Bankinter's financial performance, mainly in ROE, has shown an equally excellent execution. It has outperformed the industry's average both in 2015 and 2022, and has demonstrated continuous growth in this metric over time. The institution's achievement demonstrates it ability to harmonize financial goals with ethical business principles. However, Bankinter still faces challenges in terms of revenue generation and its market position compared to its peers; these may be areas of improvement to achieve a "Triple Play" position.

Caixabank has been considered a leader in ESG and growth performance. The bank has shown commitment to ESG factors by increasing its score from a C+ to a B and growing 5% in its ESG Disclosure Score from 2015 to 2022. Its dedication to sustainability has allowed it to overperform the industry in 2022, demonstrating its resilience and perseverance in improving its ESG performance. Additionally, Caixabank, despite not exceeding the average for Revenue, has been included as a growth overperformer due to its 3.8% CAGR revenue growth during the years 2015 to 2022 and its exceptional market capitalization performance. Caixabank's overperformance in market cap reflects robust market trust in its strategy and management, despite hurdles in revenue generation. Additionally, it was not considered a "Triple Play" bank because it was not able to surpass the average of the industry in terms of ROE and ROA. Nevertheless, it is important to mention that its growth in both financial metrics was substantial as it experiences an annual compounded growth rate of 15.9% in its ROE and 10.8% in its ROA, indicating a favorable trajectory towards enhanced efficiency and profitability in the bank's operations. Based on this analysis, if Caixabank maintains its current trajectory enhancing its profitability and further improving its sustainability performance, there is a great opportunity for the bank to establish itself as a "Triple Play" bank.

Furthermore, as displayed, Sabadell obtained an outstanding performance on ESG, demonstrating exceptional growth from 2015 to 2022, which allowed it to surpass the average of the ESG Disclosure Score in 2022. On the other hand, Sabadell failed to give that same performance on profitability and growth. This bank is an example that demonstrates that focusing only on ESG practices will not make the company improve growth and profitability performance; therefore, it gives us an insight into a further research analysis to determine which factors have prohibited Sabadell from performing as well as its competitors. Furthermore, Unicaja has displayed a lower performance in all the variables in comparison to the rest of the banks, and therefore it is not included in the Venn Diagram. Unicaja's case is also an area of further research, as its growth in sustainability factors could improve its growth and profitability in the further future.

Apart from this, the two banks, BBVA, and Santander, have shown outstanding performance in market cap, profitability, and ESG factors. Its superior performance in these key areas highlights its effectiveness in generating profits, maximizing asset utilization, and dedication to sustainable and responsible business practices. This success is remarkable considering the intricate current financial landscape, marked by record low interest rates and growing regulatory legislation on environmental, social, and governance matters. This position highlights the ability of these banks to offer attractive returns to their shareholders and their impressive ability to lay a foundation for long-term sustainable success. These two banks are the main examples that demonstrate the capability of implementing ESG factors while maintaining profitability and growth.

Lastly, its important to take into consideration that there may be other internal and external factors that might have propelled these banks growth and profitability or lack thereof. Therefore, the study has some limitations that can be researched or reviewed for further analysis.

CHAPTER 4: QUALITATIVE ANALYSIS OF THE MAIN STRATEGIES OF TWO CASES: SANTANDER AND UNICAJA

4.1 "Triple Play" Bank - Santander

Banco Santander has become one of the top performing banks included in the "Triple Play" category due to its extensive strategy that integrates growth, profitability, and ESG responsibility. For starters, one of Santander's competitive advantages to grow and be profitable is its use of intangible assets. Its intangible assets, such as talent, human resource management skills, client services, and brand image of Strategic Business Units, are highly valued for their impact on the bank's competitiveness (Lado Gonzalez & Calvo Dopico, 2017).

Additionally, in terms of growth, Santander employs a combination of intensive, integrated, and diversified growth strategies (Lado Gonzalez & Calvo Dopico, 2017). On the intensive growth strategy, it aims to boost market share by removing commissions and introducing new financial products. On the integrative side, it emphasizes acquiring other financial institutions and forming strategic collaborations. The organization then emphasizes diversification through the commercialization of new financial activities, such as insurance products.

Banco Santander also aims to enhance its reputation with customers by providing better financial conditions and eliminating service charges for specific demographics. The bank's client approach is emphasized in the phrase "We want to be your bank," demonstrating its commitment to being close and accessible to various market segments. With this said, Santander is focusing on expanding its client base and reducing costs in the Spanish market. Its aim is to increase its customer base by 10% from 2022 to 2025 and reduce its costs by implementing automated products and procedures (McElroy, 2023). Santander is also prioritizing being the digital leader in the financial industry by investing over 20 billion euros in digital transformation and technology (Santander, 2023).

As mentioned, Santander prioritizes the well-being of its customers, emphasizing transparency and implementing sustainability actions for climate well-being. For starters, Santander makes sure to have transparent communication with its stakeholders by communicating its objectives and strategies during Investor Days (Santander, 2022). The company also aims to raise its profit distribution to shareholders to 50% through cash dividends and share buybacks in 2023, demonstrating a dedication to improving shareholder value (Aguado, 2023).

Moreover, Santander has created a thorough climate strategy that emphasizes green finance, integrates climate factors into risk management, assists clients in shifting into a low-carbon economy, and aligns its portfolio with the objectives of the Paris Agreement. The company's goal is to reach net zero carbon emissions by 2050 and help clients transition to a low-carbon economy (Gómez Martínez, 2022). In addition, Santander remains a global leader in financing renewable energy as it has continued to fund initiatives in this sector for the past 10 years (Santander ESG, 2022). The bank aims to maintain its position as a leader in sustainable finance by developing its expertise in new clean energy technologies and strengthening its sustainable finance propositions. An example of Santander's commitment to sustainability is displayed through its investment of 18 billion euros in green financing and its issuing of the first green bond, of 1 billion euros, under a global strategy of sustainable issuances for the coming years. The funds from this bond will be used to finance solar energy and wind power projects (Santander ESG, 2023).

Lastly, Santander has had a major focus on helping the communities as well as developing diversity, equity, and inclusion within the company. For example, Santander has helped communities through financial inclusion initiatives, scholarship programs, and community empowerment. The bank's goal is to provide financial services to millions of individuals worldwide while addressing social issues through financial empowerment (Santander, 2022). Finally, Santander has respected diversity and equity within the company by enhancing the presence of women in leadership roles, cultivating a transparent culture, and recruiting new talent to the firm. The bank has achieved great advancements toward achieving its 2025 Diversity, Equity, and Inclusion goals by fostering an inclusive workplace (Santander, 2022). It's important to mention that Santander's main ESG strategy focuses on the social pillar. As displayed in Figure 17, from 2015 to 2022, it has mainly prioritized its growth in social aspects due to its lower value in 2015.

Figure 17:

Disclosure Scores for Environmental, Social, and Governance for Santander (2015 & 2022)

	E	S	G
SANTANDER 2015	47.36	37.61	89.86
SANTANDER 2022	34.73	57.77	89.86

Source: Own elaboration with Bloomberg data

In conclusion, Bank of Santander's strategy focuses on growth, profitability, and ESG, which establishes the bank as a front-runner in the financial industry. Its priority on intangible assets, together with its growth strategy that combines market intensification, integration through acquisitions, and diversification into new financial products, demonstrates its agility and

forward-thinking perspective. Santander also drives operational efficiency by focusing on digitalization and technological innovation. Additionally
, its dedication to ESG elements is demonstrated through its strong climate strategy and support for green financing. Its commitment to success has allowed the bank to develop a strategy that allows it to be agile within new economic environments and to develop quickly with the introduction of new innovations. All these strategies combined have led to its continuous great performance.

4.2 Unicaja

Unicaja's strategy has not been efficient enough to make it gain a position in the "Triple Play"; among all the variables analyzed, Unicaja always had the lowest ratios and maintained a position below the mean. Firstly, Unicaja's strategy is not as easily available online as Santander's strategy, which might provide some difficulties in investor trust due to the lack of information. Notwithstanding, according to (Yahoo! Finanzas, 2023), Unicaja's growth plan is founded on five main priorities: enhancing specialization to boost commercial operations, improving efficiency through operational excellence, advanced risk management with a conservative approach, improving digital banking and dedication to sustainability.

While Unicaja has implemented strategies that have helped it grow and be profitable, it does not obtain the same performance as the "Triple Play" banks for various reasons. For instance, the new banking tax in 2022 impacted Unicaja the most. Unicaja experienced a decline in value, specifically 9.5% in 2022, after seeing the financial results that gave a negative perception of financial parameters such as profitability, efficiency, and management of non-productive assets. The decline due to the new temporary banking tax, which negatively impacted its first-quarter performance, caused a 43.2% decrease in net profit (Jiménez, 2023). Analysts suggest that the results fell short of expectations due to a reduced interest margin and increased charges in other income, impacting the anticipated profitability.

Unicaja's lower performance can also be attributed to the merger with Ceiss. Initially, both banks experienced substantial deposit decline, indicating difficulties in financial trust through the merger procedure. Ceiss had a negative semiannual balance, while Unicaja had positive results.

Unicaja experienced a challenging situation trying to recapitalize Ceiss in such a difficult macroeconomic environment which jeopardized the viability of the merger, prompting Unicaja to reassess its merger plans (Servicios, 2023).

Furthermore, in the Spanish banking sector, Unicaja has encountered some issues regarding mortgage production and deposit management due to the expensive financing market and the weakened demand. Unicaja has a greater exposure to mortgage loans in comparison to the other banks analyzed; therefore, it is the one facing the most issues and facing a fragile financial performance (Jiménez, 2023).

Also, Unicaja, like the other banks, has been working on implementing ESG factors into its daily operations. Unicaja implemented a sustainable finance action plan in 2020, with the objective of focusing on governance and strategy, risk management, and the creation of sustainable goods. The initiative focused on providing loans for eco-friendly initiatives and encouraging sustainable financial practices within the company (Laidlaw, 2020). However, although Unicaja has implemented sustainability into its strategy, it's important to take into account that Santander Bank implemented it in 2015, 5 years before Unicaja, which has given Santander a tremendous competitive advantage and has left Unicaja behind.

Figure 18:

Disclosure Scores for Environmental, Social, and Governance for Unicaja (2015 & 2022)

	E	S	G
UNICAJA 2015	20.75	28.14	37.45
UNICAJA 2022	32.20	28.14	76.46

Source: Own elaboration with Bloomberg data

Nevertheless, it's important to mention that Unicaja, among the ESG factors, has placed most of its efforts in improving its governance strategy. As seen in Figure 18, from 2015 to 2022, there was a massive increase in its Governance Disclosure Score, an evaluation based on the composition of a company's board, the level of executive compensation, the protection of shareholder interests, and the implementation of anti-corruption initiatives (Burdon, 2023). This is due to Unicaja's initiative to change its entire council; the CEO of Unicaja Banco, Isidro Rubiales, has indicated that the current challenge for his entity will be profitability once it has solid foundations and the reorganization of corporate governance has been completed (Press, 2023).

Additionally, Unicaja has also taken more time to adapt to new market tendencies such as digitalization. So this eventually leads the bank to lose market cap against those other banks who have taken the initiatives sooner. For instance, Unicaja has had to resort to external companies such as Kyndril to catch up on digitalization (Unicaja, 2023).

In conclusion, Unicaja's strategy focused on specialization, operational efficiency, digital banking, and sustainability, mainly in the governance pillar, reflects a clear effort to adapt to the evolving banking environment. However, due to the significant challenges it's facing, such as the new banking tax or difficult mergers, it has experiences less growth in its profitability and market reputation. Additionally, as it introduced its ESG and digitalization strategies later on, it did not match the speed and depth of larger banks like Santander. The delay in embracing these important trends has hindered its performance in comparison to the IBEX 35 "Triple Play" banks, underscoring the significance of the strategic agility and proactivity in the current banking industry.

5. CONCLUSION

This research paper has examined how growth, profitability, and ESG principles intersect with the Spanish banking sector, more specifically, with the listed banks on the IBEX 35 stock index. The methodology involved collecting and analyzing Bloomberg data on financial performance metrics and ESG disclosure scores from the years 2015 to 2022, allowing for a detailed comparison of all these variables over a long period of time. This research has shown that financial institutions can integrate a strategy that provides profitability, growth, and sustainability simultaneously; therefore supporting the notion that being "green" is profitable.

The results indicate that the banks BBVA, and Santander have accomplished a "Triple Play" by surpassing the average in all evaluated categories, showcasing their superiority in growth, profitability and ESG initiatives. These banks have achieved and exceeded multiple financial ratios and have demonstrated remarkable growth even with a low interest environment, which can be attributed to their implementation of ESG strategies in their operational framework, and their adaptability to the ESG regulations in Spain. This achievement demonstrates effective management, a strong business strategy, and proactive approach to adapt and incorporate evolving expectations of stakeholders and the market into their daily operations. Nevertheless, while most of the banks have displayed a remarkable ESG disclosure score, Unicaja has fallen behind, highlighting the importance of embracing and adopting early the sustainable practices.

The Spanish ESG regulations have played an important role in achieving the favorable outcomes. This illustrates that a robust regulatory framework can truly incentivize change and promote proactiveness to use sustainable measures. The ESG bank results have demonstrated that the banking industry has been able to adhere to all the regulations and have also used them to enhance their performance.

Additionally, the comparison between bank Santander and Unicaja highlights the importance of implementing a "Triple Play" strategy to have a better performance than competitors. Santander has excelled in implementing sustainable practices and pursuing a robust growth and profitability plan. In contrast, Unicaja has had more troubles and has encountered obstacles that have impeded it to achieve outstanding performance in these aspects. Primarily, it has been identified that adapting to the economy, sustainability objectives and to the new digital trends have been a competitive advantage for the "Triple Play" banks, and Unicaja who has implemented these strategies later on, has been left behind. Therefore, we can conclude that in order to maintain competitiveness and success, banks must persist in incorporating sustainable strategies into their operations. This entails not just prioritizing green innovation, but also emphasizing social inclusion and ethical governance. Adapting to new technologies and digitalization will be key to improving efficiency and achieving sustainable objectives.

Ultimately, this research paper emphasizes the literature by providing a study that analyzes the interrelation between ESG factors and profitability and growth utilizing the real values of the banks. Notwithstanding, it gives another perspective due to the specific time period analyzed, the geographic region, the platform used for the data (bloomberg), and the ratios analyzed. Further analysis could include the data from different platforms such as Refinitiv to explore the differences between the platforms and its results, different geographic locations, different banks, different financial metrics, etc.

Overall, this study highlights the increasing importance of incorporating growth, profitability and ESG practices in the banking sector, both as an ethical imperative, and as a crucial element to achieve long-term financial success. Banks that adopt a proactive and holistic approach, similar to the "Triple Play" leaders, will be well-equipped to survive in the future amidst economic headwinds and new sustainability demands. This research proves that sustainability can coexist with profitability and growth, and it can even enhance and improve the performance of banking institutions in Spain.

Declaración de Uso de Herramientas de Inteligencia Artificial Generativa en Trabajos Fin de Grado

ADVERTENCIA: Desde la Universidad consideramos que ChatGPT u otras herramientas similares son herramientas muy útiles en la vida académica, aunque su uso queda siempre bajo la responsabilidad del alumno, puesto que las respuestas que proporciona pueden no ser veraces. En este sentido, NO está permitido su uso en la elaboración del Trabajo fin de Grado para generar código porque estas herramientas no son fiables en esa tarea. Aunque el código funcione, no hay garantías de que metodológicamente sea correcto, y es altamente probable que no lo sea.
Por la presente, yo, Lucía Ors Castillejos, estudiante de E-2 Bilingüe de la Universidad Pontificia Comillas al presentar mi Trabajo Fin de Grado titulado " Can Growth and Profitability Coexist with ESG?: Sustainable Banking in Spain (2015-2022)", declaro que he utilizado la herramienta de Inteligencia Artificial Generativa ChatGPT u otras similares de IAG de código sólo en el contexto de las actividades descritas a continuación:

1. Referencias: Usado conjuntamente con otras herramientas, como Science, para identificar referencias preliminares que luego he contrastado y validado.
2. Constructor de plantillas: Para diseñar formatos específicos para secciones del trabajo.
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4. Sintetizador y divulgador de libros complicados: Para resumir y comprender literatura compleja.
5. Traductor: Para traducir textos de un lenguaje a otro.

Afirmo que toda la información y contenido presentados en este trabajo son producto de mi investigación y esfuerzo individual, excepto donde se ha indicado lo contrario y se han dado los créditos correspondientes (he incluido las referencias adecuadas en el TFG y he explicitado para que se ha usado ChatGPT u otras herramientas similares). Soy consciente de las implicaciones académicas y éticas de presentar un trabajo no original y acepto las consecuencias de cualquier violación a esta declaración.
Fecha: 18 de Marzo, 2024
Firma: Lucía Ors Castillejos

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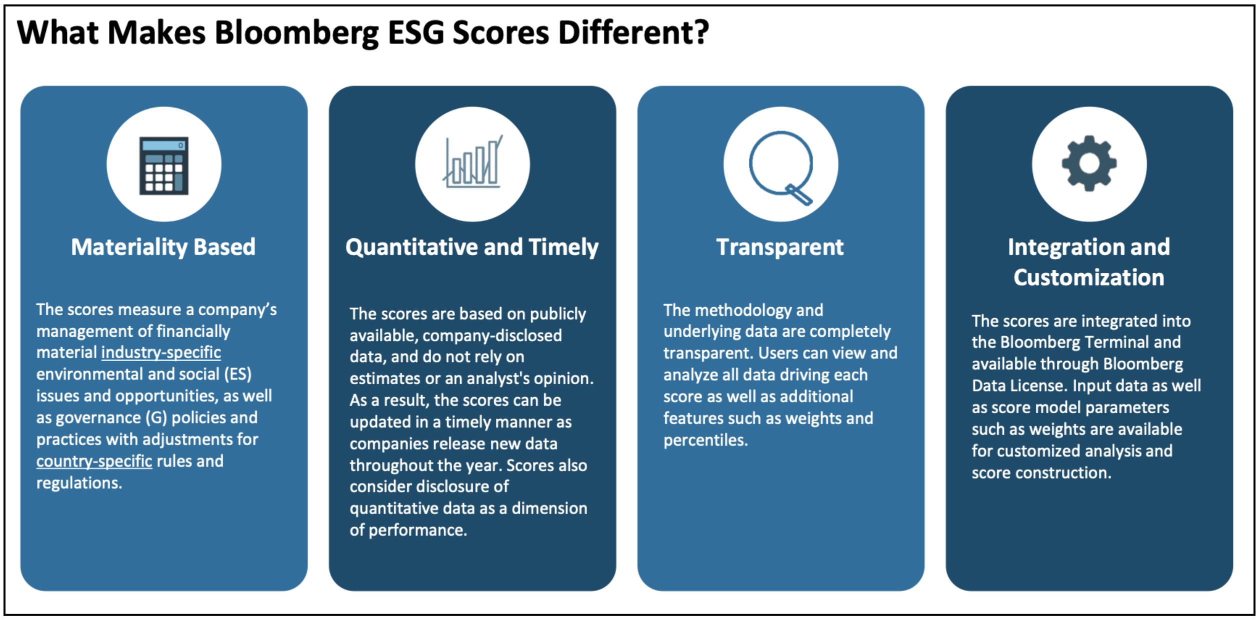
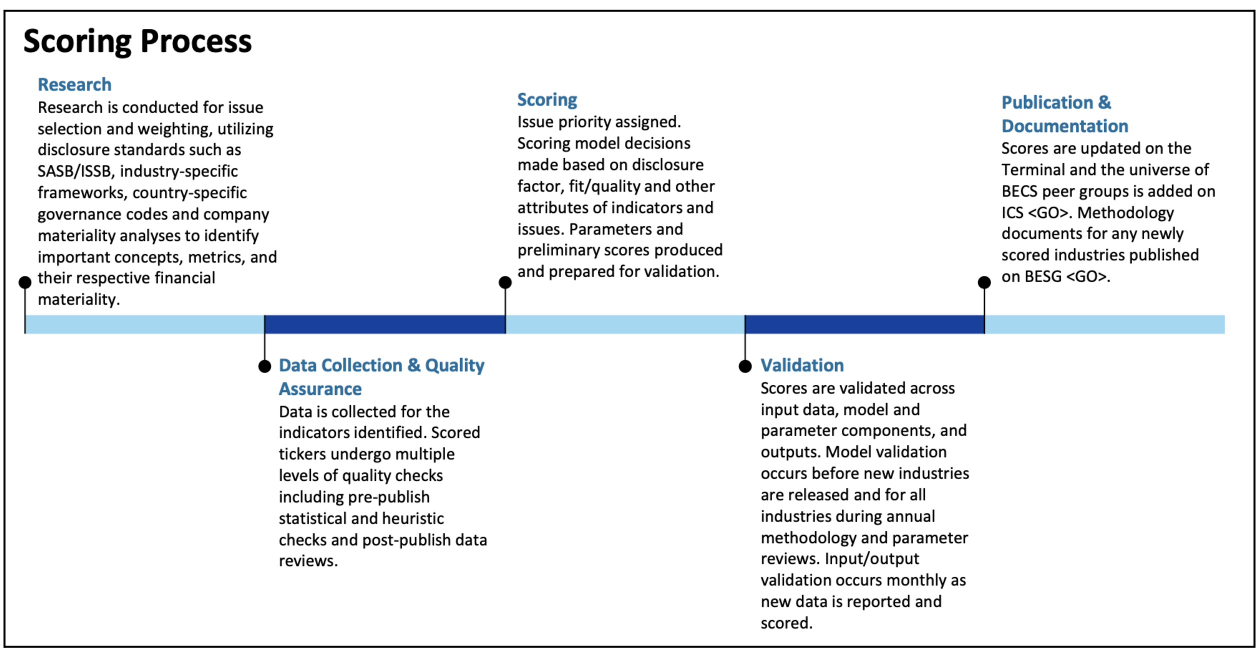
ANNEX

Annex 1:



Source: Bloomberg, 2023

Annex 2:



Source: Bloomberg, 2023