

The Cost of Responsibility: Assessing the Impact of ESG Performance on Bank Capital Costs Across Developed and Emerging Markets

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ABSTRACT

As ESG criteria gains importance in investor assessments, their impact on bank's capital costs is increasingly relevant. This study investigates whether higher ESG performance lowers the cost of equity and WACC for banks across different economic and regulatory settings. Based on agency and signaling theories, we propose that strong ESG performance reduces information gaps and boosts investor trust, resulting in cheaper financing.

We analyze panel data from 150 banks in developed and emerging markets between 2017 and 2023, using ESG scores from Refinitiv. To correct for endogeneity and hidden bank-level factors, we apply a two-step System GMM estimator. The results show a significant negative link between ESG scores and cost of equity, especially in emerging markets with weaker governance systems. The effect on WACC is smaller but follows the same downward trend.

This study adds to existing research by highlighting the financial impact of ESG integration in banking, focusing on institutional and regional variations. The results provide actionable insights for banks, investors and regulators: strong ESG performance can serve as a strategy to reduce capital costs. In transitioning economies like those in Central Asia, enhancing ESG practices and transparency may yield especially high financial advantages.

Keywords: Banking; cost of capital; ESG; emerging markets; governance; sustainability; sustainable finance; WACC